DOCUMENT RESUME

ED 188 508 HE 012 681

TITLE	Study of the Requirements for Forming State Guarantee Agencies. Final Report.
INSTITUTION	Research and Forecasts, Inc., New York, N.Y.
SPONS AGENCY	Office of Education (DHEW), Washington, D.C.
PUB DATE	11 Jun 79
NOTE	178p.
EDRS PRICE	MF01/PC08 Plus Postage.
DESCRIPTORS	Administration; Expenditures; Government School Relationship; Income; *Loan Repayment; Management Development; Needs Assessment; *Program Design; Program Evaluation; Program Proposals; *Public Agencies; *State Aid; State Government; State Programs; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS	*State Guarantee Agencies

ABSTRACT

Requirements for forming state guarantee agencies in the Guaranteed Student Loan Program are presented, based on two previous reports: "Perspectives on State Guaranteed Student Loan Programs" (March 23, 1979) and "Status Report on Non-Agency States" (March 29, 1979). After introductory material on background, purposes, and methodology, this report provides information on the following subjects, each of which comprises a chapter: organization and staffing; operations; revenues and expenses; management information, reporting and EDP support; and default rates. A final section contains recommendations intended to assist representatives of states that are considering the feasibility of a guarantee agency and/or planning the implementation of such an agency. Appendices to this volume contain descriptions of technical assistance, summary of the data collection guide, guarantee agency functions and status by state, and direct loan programs. Examples of the numerous recommendations are these: a "task force" approach to study issues should be used by states considering the formation of a guarantee agency; loan availability and default rates should be included within the scope of the study; multi-year financial projections should be performed; program planning should address all guarantee agency functions; and new agency procedures should be documented. (LC)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED188508

U.S. DEPARTMENT OF HEALTH,
EDUCATION & WELFARE
NATIONAL INSTITUTE OF
EDUCATION

THIS DOCUMENT HAS BEEN REPRODUCED EXACTLY AS RECEIVED FROM THE PERSON OR ORGANIZATION ORIGINATING IT. POINTS OF VIEW OR OPINIONS STATED DO NOT NECESSARILY REPRESENT OFFICIAL NATIONAL INSTITUTE OF EDUCATION POSITION OR POLICY

Touche Ross & Co.

June 11, 1979

Mr. Dan Morrisey
U.S. Office of Education
Office of Evaluation and Dissemination
Regional Office Building 6
Room 4085
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Reference: Study of the Requirements for
Forming State Guarantee Agencies
in the Guaranteed Student Loan Program

Dear Mr. Morrisey:

We are pleased to submit our final report for the above-referenced study. This report incorporates the results of the data collection and analysis we performed at the guarantee agencies which were in existence prior to the passage of the Education Amendments of 1976. It also reflects the experience we gained while making presentations of findings to representatives of 22 states which have either created new agencies or are considering doing so in the near future.

Under separate cover we have submitted two additional reports. The first report, Perspectives on State Guaranteed Student Loan Programs (March 23, 1979), presents certain conclusions and recommendations which we believe are significant for the future of the Guaranteed Student Loan Program. The second report, Status Report on Non-Agency States (March 29, 1979), describes the efforts taken to develop an agency by each state that did not have a guarantee agency at the time the Education Amendments of 1976 were passed. The status given is as of February 28, 1979. Readers of this volume are encouraged to also read the other two reports.

The study would not have been possible without the cooperation of the management and staff of the guarantee agencies. We would like to acknowledge our debt to these people and also to the staff personnel within the Bureau of Student Financial Assistance who made themselves available to respond to our questions. We also appreciate the full cooperation we received from you and your office throughout the course of the project.

MAY 9 1980

1900 M STREET N.W. - WASHINGTON, D.C. 20036 - (202) 452-1200

Should you or anyone to whom the report is distributed have any questions or wish to discuss our findings further, please call Mr. James McCoy or Mr. Joseph Kraemer at (202) 452-1200.

Very truly yours,

Touche Ross & Co.

3-A

FINAL REPORT

STUDY OF THE
REQUIREMENTS FOR FORMING
STATE GUARANTEE AGENCIES

* * * *

U.S. OFFICE OF EDUCATION

Table of Contents

Page

INTRODUCTION

I. BACKGROUND 1

II. PURPOSES 4

III. METHODOLOGY 5

- A. Data Collection Guide 5
- B. Functional Analysis 5
- C. Data Collection 6
- D. Nonagency Presentations 11
- E. Anonymity 11

FINDINGS AND CONCLUSIONS

IV. ORGANIZATION AND STAFFING 12

- A. Introduction 12
- B. Organizational Structure 12
- C. Staffing 14

V. OPERATIONS AND PRACTICES 25

- A. Introduction 25
- B. Loan Processing 27
- C. Claims and Collections 42
- D. External Relations 62
- E. Comprehensive Servicers 70

VI. REVENUES AND EXPENSES 74

- A. Revenues 74
- B. Expenses 77

Page

C. Reserves 85

D. Financial Viability 85

VII. MANAGEMENT INFORMATION, REPORTING AND EDP SUPPORT 87

A. Introduction 87

B. Management Information 87

C. EDP Support 94

VIII. DEFAULT RATES 100

A. Introduction 100

B. Default Rate Calculation 100

C. Default Rate Analysis 102

D. Perspectives on Default Rates 105

RECOMMENDATIONS

IX. SUMMARY OF RECOMMENDATIONS 107

A. Evaluation Phase: Policy Issues 107

B. Evaluation Phase: Financial Issues 109

C. Evaluation Phase: Organizational Issues 111

D. Evaluation Phase: Financial Projections 112

E. Implementation Phase: Initial Activities 113

F. Implementation Phase: Program Development 114

G. Implementation Phase: External Relations 117

Page

Appendix A: DESCRIPTION OF TECHNICAL ASSISTANCE A-1

Appendix B: SUMMARY OF THE DATA COLLECTION GUIDE B-1

Appendix C: GUARANTEE AGENCY FUNCTIONS C-1

Appendix D: GUARANTEE AGENCY STATUS BY STATE D-1

Appendix E: DIRECT LOAN PROGRAMS E-1

List of Exhibits

Number	Title	Page
I-1	GUARANTEED STUDENT LOAN PROGRAM VOLUMES	2
III-1	CHARACTERISTICS OF ESTABLISHED AGENCIES	7-10
IV-1	BASIC GUARANTEE AGENCY ORGANIZATIONAL STRUCTURE	13
IV-2	PATTERN OF FULL TIME EQUIVALENT STAFF BY FUNCTION	16-17
IV-3	PRODUCTIVITY MEASURES	18
V-1	TURNAROUND TIME (FY77): AUTOMATED vs. MANUAL LOAN APPROVAL PROCESSING SYSTEMS	29
V-2	LOAN APPROVAL: COST PER LOAN GUARANTEED (FY77)	33
V-3	ESSENTIAL LOAN SERVICING: COST PER LOAN OUTSTANDING	36
V-4	RANGE OF PRACTICES: PRECLAIMS ASSISTANCE, CLAIMS PROCESSING AND COLLECTIONS	44-45
V-5	PRECLAIMS ASSISTANCE: CURE RATES AND UNIT COSTS (FY77)	50
V-6	COLLECTIONS: COST PER DOLLAR RECOVERED (FY77)	57
V-7	GUARANTEE AGENCY RECOVERY RATES	59
V-8	RECOVERY RATE CALCULATIONS	61
VI-1	REVENUE PATTERNS (FY77)	75
VI-2	EXPENSE PATTERNS BY FUNCTION (FY77)	78-79
VI-3	OPERATING EXPENSES (FY77)	81
VI-4	MODEL OPERATING EXPENSE PATTERNS (FY77)	83
VI-5	MODEL EXPENSE PATTERNS BY FUNCTION (FY77)	84
VII-1	OE FORM 1130	91
V11-2	FORM 1130: REPORTING OF OUTSTANDING LOANS AND CLAIMS PAID	92
VII-3	GUARANTEE AGENCY COMPUTER HARDWARE SUPPORT	98

		Page
VIII-1	CUMULATIVE DEFAULT RATES (END OF FY77)	103
E-1	DIRECT LOAN PROGRAM CHARACTERISTICS	E-3
E-2	COMPARISON OF COMMERCIAL AND DIRECT LENDING VOLUMES	E-9

PREFACE

This volume is organized into three sections and a series of appendices. The first section is the Introduction which consists of three chapters (Background, Purposes, and Methodology). The second consists of findings and conclusions. These are organized into the following subjects, each of which comprises a chapter:

- ORGANIZATION AND STAFFING
- OPERATIONS
- REVENUES AND EXPENSES
- MANAGEMENT INFORMATION, REPORTING AND EDP SUPPORT
- DEFAULT RATES

The third section contains recommendations which are intended to assist representatives of states which are considering the feasibility of a guarantee agency and/or are planning the implementation of such an agency.

The appendices to this volume contain information which may be valuable for reference but which was not thought to be appropriate for incorporation into the body of the report. However, the appendices support and supplement the other portions of the report.

INTRODUCTION

I. BACKGROUND

In response to the national need for educational assistance, Congress passed the Higher Education Act of 1965 (P.L. 89-329. enacted November 8, 1965). Title IV of the act established a national program of guaranteed student loans. The emphasis of Title IV was upon state guarantees of student loans. The Federal government was to (1) reinsure loans guaranteed by states or by qualified private, non-profit corporations or (2) provide direct Federal guarantees in areas where student borrowers did not have "reasonable access" to the loan guarantee program of a state or private, non-profit corporation. To promote state participation, Congress appropriated funds to be used by states with guaranteed student loan programs as reserves to pay default and other claims. The Federal government also provided interest subsidies to students in the form of direct payments to lenders.

In 1967, amendments to the Higher Education Act expanded the direct insurance role of the Federal government. Over time approximately one half the states elected to participate in the Federally Insured Student Loan Program while the remaining states developed their own programs. This dual insurance approach has continued to the present.

Legislation passed between 1967 and 1975 modified the program by providing additional incentives for lender participation, increasing maximum loan size, altering school eligibility requirements and creating a secondary market for student loans through the Student Loan Marketing Association. However, during this period the role of the Federal and state governments remained essentially unchanged. It is relevant to note, however, that the greatest growth of the Federal program occurred prior to FY76 and that in recent years the state programs have been reponsible for an increasing percentage of total annual loans guaranteed and total loans outstanding. Exhibit I-1, GUARANTEED STUDENT LOAN PROGRAM VOLUMES, shows a summary of the annual volumes for the period FY-74 - FY-78.

By 1976, the Federally Insured Student Loan Program had developed significant operating problems which received wide publicity and became the subject of Congressional hearings. The major criticisms directed at the Office of Education at that time were:

- Poor program administration leading to the withdrawal of commercial lenders because of late payments and burdensome regulations;
- Failure to initiate a collections program on defaulted loans;

Exhibit I-1
Page 1 of 1

Guaranteed Student Loan Program Volumes

Fiscal Year	Dollar Volume FISL A/	Dollar Volume Guarantee Agencies B/	Dollar Volume Total	Percentage of Total Volume FISL	Percentage of Total Volume Guarantee Agencies	Percentage of Total Volume Total
FY 74	$611.6	$ 527.8	$1,139.4	53.7%	46.3%	100.0%
FY 75	661.3	637.2	1,298.5	50.9	49.1	100.0
FY 76	558.7	708.2	1,256.9	44.1	55.9	100.0
Transition Quarter C/	181.2	379.7	560.9	32.3	67.7	100.0
FY 77	500.4	1,036.9	1,537.3	32.6	67.4	100.0
FY 78	473.5	1,484.4	1,957.9	24.2	75.8	100.0

Source: U.S. Office of Education

A/ Loan commitments

B/ Loan guarantees

C/ The period July-September, 1976 is considered a transition quarter because the Federal government switched at that time from a June 30 fiscal year end to a September 30 fiscal year end.

- Failure to maintain accurate and accessible records on the current status of loans guaranteed; and
- Excessively high default rate.

In contrast, the state guaranteed loan programs generally appeared to be better administered, enjoy the confidence of their commercial lending communities, have lower default rates, be more aggressive in collecting on defaulted loans and be more responsive to the local needs of participating lenders and schools.

Because of the comparatively better performance of the state guaranteed loan programs, Congress reaffirmed its intention in the Education Amendments of 1976 (P.L. 94-482, enacted October 12, 1976) that a guaranteed student loan agency should be established in each state.* The Amendments provided substantial financial incentives for states to operate or create a guarantee agency. As a result of this legislation and other factors, the number of loan guarantors has increased by approximately 50% since 1976. Appendix D shows the status of each state with respect to the creation and operation of a guarantee agency.

---

* For purposes of this Act, the term "state" includes the Virgin Islands, Puerto Rico, the District of Columbia, and certain island territories in the western Pacific.

II. PURPOSES

Section 421(c) of the Education Amendments of 1976 required the Commissioner of Education to develop a plan to encourage the creation of guarantee agencies. As one part of its response to the intent of Congress, the Office of Education engaged Touche Ross & Co. to undertake a study which has two phases. The first phase involved data collection and analysis at each existing guarantee agency. The first phase of the study has been completed. This volume constitutes the final report of that phase.

The purposes of this volume are as follows:

1. To summarize our findings based on data collection and analysis at every established state guarantee agency;*
2. To provide useful information concerning the operations of existing agencies to representatives of new and established agencies, as well as representatives of nonagency states who are charged with the responsibility of studying the issues associated with creating an agency; and
3. To present recommendations which have the potential to improve the operations of both new and established guarantee agencies.

In a previous report (dated August 25, 1978), we summarized certain interim findings based upon data collected at eight existing guarantee agencies. The findings in that report were interim in nature and are superseded by the findings contained in this final report.

The second phase of the study consists of the provision of technical assistance to states with existing or planned agencies. Representatives of new agencies and of states considering the creation of an agency have been notified by the Office of Education of the availability of assistance. Such assistance must be approved by the Office of Education, but there is no direct cost to the state or agency which receives such assistance. Appendix A, DESCRIPTION OF TECHNICAL ASSISTANCE, contains a summary description of the types of activities which may be included in technical assistance.

---

* It is not an objective to publish in this volume all the information obtained during the data collection and analysis phase. The data presented is that which would be informative and helpful to the management of the new and established agencies.

III. METHODOLOGY

A. DATA COLLECTION GUIDE

In order to analyze the diverse set of existing agencies, a Data Collection Guide was developed. This Guide provided for a consistent methodology to be employed at each agency. Collected data was organized and recorded in such a manner as to facilitate analysis on a consistent basis within and between agencies.

The Data Collection Guide with forms and appendices consisted of over 150 legal pages. Because of its bulk, it has not been reproduced as part of this report. However, Appendix B, DESCRIPTION OF THE DATA COLLECTION GUIDE, contains a summary of the Guide including a description of the cost allocation methodology.

B. FUNCTIONAL ANALYSIS

For purposes of this study, ten operating and administrative functions which a guarantee agency may perform were identified. These functions comprise the basic program operating activities to which an agency's full time equivalent staff and costs were allocated. A series of quantitative indicators were developed for use in making comparisons between programs in different states.

Because of their significance to the entire data collection and analysis, as well as to show states considering such agencies the full range of activities engaged in by a guarantee agency, Appendix C, GUARANTEE AGENCY FUNCTIONS, presents the functions and their component activities.

These functions are as follows:

1. Loan Approval Processing;
2. Essential Loan Servicing;
3. Special Loan Servicing;
4. Preclaims Assistance;
5. Claims Processing;
6. Collection;
7. Regulation and Compliance
8. Lender Promotion

9. School and Student Liaison; and
10. Administration.

C. DATA COLLECTION

In-depth data collection took place at 24 of the 26 state guarantee agencies which existed at the time the Education Amendments of 1976 were passed. Of the other two agencies, the program in the District of Columbia was discontinued prior to the start of our project,* and the data collection in another state was abbreviated in scope because of prior commitments on the part of a relatively small agency staff. Consequently, the data analyses we performed were based on a maximum of 24 agencies. Many analyses were, in fact, based on fewer than 24 because data collected at one or more agencies was not considered sufficiently reliable and/or consistent to be included in the analysis. Several analyses also excluded the six states using comprehensive servicers.

Exhibit III-1, CHARACTERISTICS OF ESTABLISHED AGENCIES, identifies each agency and lists a limited number of agency characteristics. The Exhibit organizes the agencies into small, medium and large agencies (based on annual volume); for purposes of analysis this three tiered classification is retained throughout this report.

In addition to these established agencies, visits were made to eleven agencies which were created subsequent to the Education Amendments of 1976. The purposes of the visits to these new agencies were as follows:

- To assist the management of these agencies to plan the implementation of the new agencies;
- To provide information on those operational practices of the established agencies which appeared to be most effective; and
- To identify start up experiences and costs which would be of assistance to nonagency states in the process of planning the implementation of an agency.

---

* We did document the reasons why the program was discontinued and examined the direct access loan program (sponsored by the Office of Education) which is currently in operation in the District of Columbia.

Exhibit III-1
Page 1 of 4

Characteristics Of Established Agencies: Large Agencies A/

	Agency Title	FY77 Loans Guaranteed (millions)	FY77 Program Operating Costs (thousands) B/	Approximate FY77 Full Time Equivalent Staff	Year Began Operations
1.	New Jersey Higher Education Assistance Authority	$103.0	$ 597	37	1960
2.	Pennsylvania Higher Education Assistance Authority	168.7	1,752	59	1965
3.	New York Higher Education Services Corporation	299.7	4,996	244	1958

A/ Annual loan volume exceeds $100 million.

B/ Excludes lender fees.

Exhibit III-1
Page 2 of 4

Characteristics Of Established Agencies: Medium Agencies A/

	Agency Title	FY77 Loans Guaranteed (millions)	FY77 Program Operating Costs (thousands) B/	Approximate FY77 Full Time Equivalent Staff	Year Began Operations
1.	Ohio Student Loan Commission	$34.8	$749	34	1962
2.	Michigan Higher Education Assistance Authority	45.4	588	26	1962
3.	Wisconsin Higher Education Aids Board	48.5	499	33	1967
4.	Illinois State Scholarship Commission	51.9	946	54	1966
5.	Connecticut Student Loan Foundation	53.0	655	37	1965
6.	Massachusetts Higher Education Assistance Corporation	59.3	623	26	1956

A/ Annual loan volume is between $15 and $100 million.

B/ Excludes lender fees.

Exhibit III-1
Page 3 of 4

Characteristics Of Established Agencies: Small Agencies A/

	Agency Title	FY77 Loans Guaranteed (millions)	FY77 Program Operating Costs (thousands) B/	Approximate FY77 Full Time Equivalent Staff	Year Began Operations
1.	District of Columbia Student Loan Insurance Program	D/	D/	D/	1966
2.	Alaska Commission on Post Secondary Education	$ .1	$ 14	C/	1974
3.	Nevada Department of Education	1.7	68	C/	1969
4.	Oklahoma Board of Regents for Higher Education	2.5	E/	E/	1965
5.	Student Loan Foundation of Arkansas	3.2	101	5	1966
6.	Delaware Higher Education Foundation	3.2	64	C/	1966
7.	Vermont Student Assistance Corporation	4.9	216	11	1965
8.	New Hampshire Higher Education Assistance Authority	5.3	156	6	1971
9.	North Carolina State Educational Assistance Program	5.8	177	C/	1964

A/ Annual loan volume is less than $15 million.

B/ Excludes lender fees.

C/ Less than one full time equivalent because a comprehensive servicer was used.

D/ Agency ceased guaranteeing loans in 1976.

E/ Oklahoma Board of Regents did not fully participate in our review.

Exhibit III-1
Page 4 of 4

Characteristics Of Established Agencies: Small Agencies A/ (continued)

	Agency Title	FY77 Loans Guaranteed (millions)	FY77 Program Operating Costs (thousands) B/	Approximate FY77 Full Time Equivalent Staff	Year Began Operations
10.	Louisiana Governor's Commission on Education Services	6.3	332	22	1964
11.	Maine Department of Educational and Cultural Services	6.4	345	C/	1968
12.	Oregon State Scholarship Commission	8.3	244	13	1967
13.	Rhode Island Higher Education Assistance Corporation	8.9	144	7	1962
14.	Tennessee Student Assistance Corporation	9.2	119	6	1974
15.	Maryland Higher Education Loan Corporation	10.4	334	8	1965
16.	Georgia Higher Education Assistance Corporation	11.6	709	27	1965
17.	Virginia State Education Assistance Authority	12.4	141	5	1961

A/ Annual loan volume is less than $15 million.

B/ Excludes lender fees.

C/ Less than one full time equivalent because a comprehensive servicer was used.

D/ Agency ceased guaranteeing loans in 1976.

E/ Oklahoma Board of Regents did not fully participate in our review.

We also visited United Student Aid Funds, Inc. (USAF) which is the servicer for ten state guaranteed loan programs.* The purposes of our visit were (1) to complete the data collection for the five established state programs using USAF and (2) to review the services offered by USAF to new and established agencies.

Representatives of nonagency states are interested in approaches which may be taken to encourage lender participation and to encourage cooperation between lenders, guarantee agencies and educational institutions. Therefore, representatives of lending and educational institutions were interviewed in each state where there was an existing guarantee agency. This was done in order to provide information on factors affecting the relationships of guarantee agencies with the other types of institutions.

D. NONAGENCY PRESENTATIONS

As part of an effort to encourage nonagency states to create guarantee agencies, we presented the findings from our interim report to representatives of 13 states which had yet to sign a guarantee agency agreement with the Office of Education. These representatives were charged by the Governors of their respective states to study the issues associated with creating a guarantee agency. These presentations normally took place in a public meeting before an audience of lender, school, legislative and student representatives. Representatives of the Office of Education and of the National Council of Higher Education Loan Programs participated with Touche Ross in giving these presentations. The questions asked during the public presentations and in private discussions with state representatives during our visits assisted in the identification of the areas of concern and the needs for assistance of the nonagency states.

E. ANONYMITY

The anonymity of participating agencies was guaranteed in advance. Consequently, whenever possible, only summary data is presented in this report. Whenever it was necessary to refer to a specific agency, an alphabetical designator was used.

---

* USAF services five established state programs (Maryland, Nevada, Maine, Alaska, and Delaware) and five new state programs (California, Utah, Indiana, Iowa and the Virgin Islands.)

FINDINGS AND CONCLUSIONS

IV. ORGANIZATION AND STAFFING

A. INTRODUCTION

The purpose of this section is to present certain findings and conclusions with respect to the organization and staffing of the established guarantee agencies. The material presented in this chapter has been used by us in assisting states to plan the implementation of new guarantee agencies. There is one basic theme which recurs in any discussion of organizational structure: INDEPENDENCE. Independence is the ability of the management of a guarantee agency to control its operations and to plan future operations without an undue amount of clearance required from other parts of the state government. In this sense, the private, non-profit corporation is, by definition, the most independent form of guarantee agency since the state does not retain any administrative responsibility for the program.

It is important to recognize, however, that any guarantee agency must operate within the broad boundaries of the educational policies established by state authorities. Guarantee agency management personnel must work with state agencies and state legislative committees to build support for agency policy. Consequently, no guarantee agency can be totally independent of the political process and/or the major educational policies prevailing in a state.*

B. ORGANIZATIONAL STRUCTURE

Of the established guarantee agencies, the organizational structures could be classified into one of three categories.

- Responsibility for the program including the guarantee function, was assigned to a private non-profit corporation.
- The state was designated the guarantor, but program administration was contracted out to a non-profit corporation (the servicer).
- The state was designated as the guarantor, and a state agency, board, public corporation, commission or department administered the program.

---

* Private, non-profit guarantors are structurally the most independent. This may account for the fact that two of the three private non-profit guarantors which we visited had significant disputes with state authorities during the 1977-78 period. One of the two was, in fact, absorbed by the state shortly before our visit.

Among the established agencies studied by Touche Ross, the breakdown between the structural options were as follows:

• Private Non-Profit Corporation or Guarantor	3*
• Comprehensive Servicer	6
• State Agency	15
	24**

As part of our analysis, organizational structure was cross-referenced with other variables. The results were inconclusive. There was no evidence that a particular structure was more cost effective, was associated with a lower default rate or was more successful in stimulating the private lending sector to provide capital for student loans.

There tended to be a common organizational structure in the agencies, which is shown on Exhibit IV-1, BASIC GUARANTEE AGENCY ORGANIZATIONAL STRUCTURE. The exhibit shows the functional activities of each major subdivision of the typical guarantee agency. In the event an agency chooses to engage a comprehensive servicer, "Loan Processing", "Claims and Collection," and a significant amount of "Administrative Support" are usually provided by a servicer.

C. STAFFING

During on-site data collection, we interviewed the management and staff of each agency. One purpose of the interviews was to allocate the time of each employee between the functional activities performed by a guarantee agency.***

---

* This breakdown reflects the situation in FY77 which was the operational year which is analyzed in the study. Subsequent to FY77, the private non-profit corporation serving Rhode Island was absorbed by the state which is the current administrator of the program. In addition, four states (Idaho, Kansas, Minnesota and South Dakota) with new agencies chose private non-profit corporations as guarantors.

** Excluded the District of Columbia and Oklahoma because they were not included in the in-depth data collection portion of the study.

*** A list of these functions and the activities which comprise them is presented in Appendix C, GUARANTEE AGENCY FUNCTIONS.

This process allowed us to determine the actual full time equivalent staff for each agency by function for FY77. This enabled us to improve the value of inter-agency comparisons of staffing patterns and productivity, and provided the basis for projecting certain staff levels and patterns in new agencies.

1. Full Time Equivalent (FTE) Staff

The largest single component of operating costs for the guarantee agencies was employee compensation, which included salaries and fringe benefits. Based on FY77 data collected at the 18 agencies which administered their own programs (i.e., did not use a servicer), employee compensation averaged 62.4% of total annual operating expenses (excluding any incentive fees paid to lenders). The number of FTE staff required to administer the program ranged from a low of 5 to a high of 244.

2. Staffing Patterns

In addition to the absolute numbers of staff employed, consideration must be given to staffing patterns. The percentage of FTE staff allocated by function is shown on Exhibit IV-2, PATTERN OF FULL TIME EQUIVALENT STAFF BY FUNCTION. Agencies have been categorized by annual volume of loans guaranteed. The pattern which emerges is one in which small agencies devote proportionately more staff to basic activities (i.e., Loan Approvals and Loan Servicing) than medium and large agencies. As the annual volume increases, proportionately more staff time is put into other activities, particularly Preclaims Assistance and Collections.

The second part of Exhibit IV-2 provides an allocation by function of the average FTE's for each agency size category. The purpose is to illustrate a typical agency's distribution of staff by function. The actual allocation of staff in a given agency should be based on such variables as loan volume, proportion of collection activities performed by outside agencies and level of lender services provided.

3. Productivity

As part of our analysis, certain productivity measures were developed. The purpose of these calculations was to derive some benchmarks for use by new agencies. The most significant productivity measures are discussed below and shown on Exhibit IV-3, PRODUCTIVITY MEASURES.

Exhibit IV-2
Page 1 of 2

Pattern Of Full Time Equivalent Staff By Function

	Small Agencies A/ (n=9)		Medium Agencies A/ (n=6)		Large Agencies A/ (n=3)	
Function	Range	Average	Range	Average	Range	Average
Loan Approval	12.4%-33.0%	25.3%	10.0%-34.2%	20.0%	12.3%-15.5%	14.1%
Essential Loan Servicing	7.2%-30.4%	16.1	8.2%-22.2%	13.5	6.3%-12.0%	10.1
Interest Billing	.9%-12.2%	1.5	NM	2.9	NM	3.0
Student Status Verification	1.2%- 9.8%	3.7	1.3%- 3.7%	.8	.8%-8.4%	3.7
Preclaims Assistance	1.0%-14.1%	6.6	.3%-38.7%	13.1	10.6%-24.2%	16.2
Claims Processing	5.0%-19.7%	9.3	4.0%-18.0%	10.4	5.4%-11.6%	9.0
Collections	4.6%-24.7%	13.6	8.7%-33.1%	16.4	16.8%-24.6%	21.5
Regulation and Compliance	.4%- 8.9%	3.1	.5%- 5.0%	2.3	1.0%-8.7%	3.8
Lender Promotion	.6%- 7.5%	3.3	2.3%- 9.7%	4.9	1.0%-6.0%	3.3
School Liaison	.2%- 5.2%	1.6	.3%- 1.8%	1.0	.5%-5.6%	2.6
Administration	9.6%-24.6%	15.9	9.1%-19.6%	14.7	7.9%-16.1%	12.7
		100.0%		100.0%		100.0%

NM = Not meaningful because two or fewer agencies provide the service.

A/ For purposes of this analysis, small agencies are those with an FY77 volume of loans guaranteed less than $15 million; medium agencies are those with an FY77 volume of loans guaranteed between $15 million and $100 million; large agencies are those with an FY77 volume of loans guaranteed greater than $100 million; agencies using servicers were excluded.

Exhibit IV-2
Page 2 of 2

Pattern Of Average Full Time Equivalent Staff By Function

Function	Average FTE Per Function A/			
	Small Agencies B/ (n=9)	Medium Agencies B/ (n=6)	Large Agencies B/ (n=3)	Large Agencies C/ (n=2)
Loan Approval	2.9	7.0	15.9	6.5
Essential Loan Servicing	1.8	4.7	11.4	5.7
Interest Billing	.2	1.0	3.4	-
Student Status Verification	.4	.3	4.2	.6
Preclaims Assistance	.7	4.6	18.3	9.1
Claims Processing	1.1	3.6	10.2	3.7
Collections	1.5	5.7	24.3	9.6
Regulation and Compliance	.4	.8	4.3	2.4
Lender Promotion	.4	1.7	3.7	1.7
School Liaison	.2	.4	2.9	1.5
Administration	1.8	5.1	14.4	7.2
Total FTE	11.4 D/	34.9 D/	113.0 D/	48.0 D/

A/ Allocation by function is according to the averages for each agency size category as given on page 1 of this Exhibit.

B/ Definitions of "small," "medium" and "large" are given on page 1 of this exhibit.

C/ Excludes New York, due to the extreme difference in number of staff between the New York agency and the two other large agencies.

D/ Average FTE staff required based on the simple average of all agencies in that category; agencies using comprehensive servicers are excluded.

Exhibit IV-3
Page 1 of 1

Productivity Measures A/

LOAN APPROVALS

	Number	Loans Approved (FY77) Per Loan-Approval-FTE Range	Loans Approved (FY77) Per Loan-Approval-FTE Average
Small Agencies	9	813-5,639	2,955
Medium Agencies	6	3,860-12,623	5,882
Large Agencies	3	4,804-12,166	9,278
	18		

ESSENTIAL LOAN SERVICING

	Number	Number of Loans Outstanding (End FY77) Per Loan-Servicing-FTE Range	Number of Loans Outstanding (End FY77) Per Loan-Servicing-FTE Average
Small Agencies	9	6,817-82,230	35,523
Medium Agencies	6	25,895-75,758	43,944
Large Agencies	3	62,527-77,019	69,846
	18		

OVERALL PRODUCTIVITY

	Number	Number of Loans Outstanding (End FY77) Per Agency-FTE Range	Number of Loans Outstanding (End FY77) Per Agency-FTE Average
Small Agencies	9	1,298-11,526	4,666
Medium Agencies	6	3,713- 7,913	5,210
Large Agencies	3	3,921- 9,133	7,157
	18		

A/ The amount of time a staff person devoted to a particular function (e.g., Loan Approval, Loan Servicing, Claims, etc.) was determined based upon a review of employee time reports and personal interviews. This was used to arrive at the number of full time equivalent (FTE) staff per function.

a. Loan Approvals

Loan Approval productivity reflects the economies of scale inherent in volume processing. The large agencies tend to rely on automation which increases the volume of loans which may be processed by each FTE staff person engaged in loan approval processing.*

The most productive agency (12,623 approvals per loan approval FTE) was a medium sized agency which used an automated loan approval process. More importantly, however, the agency was well managed and had an experienced staff to implement a good set of written procedures. The small agency at the top of its range (5,639 approvals per loan approval FTE) did not issue a written notice of guarantee to its lenders but operated under an exception system in which the lender was to assume a loan was guaranteed unless notified to the contrary. This approach significantly reduces the staff workload (thereby increasing productivity), but it is not recommended since it eliminates the audit trail necessary to establish that a guarantee was in fact made.

The least productive agency (813 approvals per loan approval FTE) was a small agency which appeared to be overstaffed and had an inefficient workflow for guaranteeing new loans. The medium (3,860 approvals per loan approval FTE) and large (4,804 approvals per loan approval FTE) agencies at the bottom of their respective ranges were seriously concerned about fraud and abuse and, therefore, devoted large amounts of time and resources to edits and file checks on applications. This reduced their processing productivity statistics relative to other agencies, but such procedures were judged by agency management to be necessary in these particular states because of the potential for abuse which existed.

---

* As discussed in Chapter V, automation does not necessarily reduce unit costs or turnaround time, but it may reduce the staff level required to process a given volume of loans.

b. Essential Loan Servicing

An analysis of the productivity statistics showed that the larger the volume of loans outstanding, the more potential the operation had to increase its productivity. There was, however, an additional variable besides volume which must be considered. This was the general level of loan servicing activity by a given agency. Agencies which emphasized the need for lenders and schools to periodically advise the agency on changes in data elements in the loan records (e.g., changes in matriculation status or of a borrower's address) generated more transactions. This increased staff requirements and reduced the level of loans serviced per FTE staff person.

The most productive agency (82,230 loans outstanding per servicing FTE) was a small, well run agency with an efficient staff. The processing staff was cross-trained in both loans and grants and was employed on one or the other depending on the season of the year. This agency also performed a minimum level of servicing and had effective data processing support.

The medium agency with the best productivity statistics (75,758 loans outstanding per servicing FTE) performed only minimal servicing activities. This made the agency appear to be effective relative to others when, in reality, it had only a rudimentary servicing capacity in place in FY77. The large agency at the top of the range (77,019 loans outstanding per servicing FTE) did appear reasonably efficient and did process a large number of transactions.

The medium (25,895 loans outstanding per servicing FTE) and large (62,527 loans outstanding per servicing FTE) agencies which showed the lowest productivity both processed a large number of change transactions (e.g., borrower address changes) and did not organize and manage this function efficiently. The least productive agency (6,817 loans outstanding per servicing FTE) was the same one that was least productive at processing loan approvals; this agency suffered from general over-staffing.

c. Overall Productivity

The most productive large agency (9,133 loans outstanding per agency FTE) enjoyed economies of scale in its operations due to its size. At the other extreme, the agency shown to be least productive (1,298 loans outstanding per agency FTE) was too small to enjoy significant economies of scale; this small agency also appeared to be over-staffed relative to other agencies with comparable volumes.

The small (11,526 loans outstanding per agency FTE) and the medium (7,913 loans outstanding per agency FTE) agencies at the top of the ranges performed minimal portfolio servicing in FY77. They also lacked sufficient staff to perform such necessary functions as Lender Promotion, School and Student Liaison and Regulation and Compliance.

The medium (3,713 loans outstanding per agency FTE) and large (3,921 loans outstanding per agency FTE) agencies at the bottom of the ranges were active agencies which provided extensive services to lenders. Because these agencies provided an above average volume of services (which required more staff), their productivity statistics appeared lower relative to other agencies of comparable size.

d. Productivity Summary

As described above, there are several factors which affected the productivity statistics:

- Staff training;
- Quality of management;
- Written procedures;
- Economies of scale;
- Automation;
- Fraud and abuse file checks; and
- Level of loan servicing activities.

Staff productivity statistics alone can not be the sole criterion for judging an agency's performance. These statistics provide quantitative measures of certain aspects of agency performance. However, these quantitative measures are not meaningful by themselves and can be misleading unless the quality of performance and the variances in agency policies are taken into consideration.

4. Labor Intensity of Functions

As a measure of labor intensity, direct labor cost as a percentage of total cost for each function was calculated. Based on this indicator, the most labor intensive functions are:

- Preclaims Assistance;
- Claims Processing;
- Regulation and Compliance;
- School and Student Liaison; and
- Administration

The five functions cited above do not appear to have the potential to become significantly more efficient in their use of labor as a result of being automated. Although Loan Approvals and Loan Servicing may also be labor intensive, these functions allow for a trade-off between manual and automated processing. For example, a computer can be programmed to compare information entered from an application against previous borrower information (e.g., the cumulative total of previous loans). This reduces the time and effort spent manually reviewing loan applications.

Because Collections and Lender Promotion require personal communications with defaulters and lender representatives, respectively, both of these functions tend to be labor intensive. However, some agencies contract for collection services, and some agencies award fees to lenders for participation. These practices have the impact of reducing the percentage of direct labor cost relative to other operating costs for these functions.

5. Seasonal and Part-Time Staff

There is a seasonal pattern to a guarantee agency's workload. The heaviest volume of loan approvals occurs in July, August and September. To avoid an excessive number of full time staff on the payroll all year to meet the summer peak, many agencies utilize temporary help. Since the skills required to process loan guarantee requests are very basic (provided close and experienced supervision is available), the use of such help appeared to be an effective approach to dealing with the seasonality of processing volumes.

In addition to seasonal staff, several agencies also use less-than-full-time staff for the entire year. Part-time staffing of positions in the Collections Department was especially prevalent since there was a tendency to have collectors work in the evening and on Saturdays in order to contact borrowers. Some agencies participated in College Work Study and obtained part-time staff through this program.

Part-time staff usually do not receive the complete package of fringe benefits available to full time staff, which reduces the cost of personnel compensation. Furthermore, seasonal and part-time staff are usually easier to hire and lay-off, which facilitates control of staff performance.

6. Executive Compensation

Executive compensation was analyzed for the executive responsible for the operation of the loan program. This position is either the director of a single program agency or the loan program manager in a multiprogram agency.* Executive compensation did not differ significantly between the single program agencies and multiprogram agencies.

Compensation was similar for both medium and large states. The range was $29,000 to $48,000. Compensation in a small state was significantly less (approximately fifty percent of the compensation for medium and large states). The range was $15,000 to $26,000.

Guarantee agencies have to pay competitive compensation in order to attract high quality top management and other supervisory personnel. If there are restraints (e.g., civil service pay scales) on the ability of an agency to pay competitively, the quality of the operation can suffer. For example, several new agencies have been precluded by state civil service regulations from paying a program director at a level commensurate with the responsibility for developing and managing a guarantee agency. In the long run, such false economy could lead to potentially serious difficulties.

---

* A multiprogram agency is one in which other forms of student financial aid are administered by the same agency which is responsible for the loan program.

7. Staff Turnover

In general, the guarantee agencies have experienced low turnover both in top management and the staff. The ability to retain staff ensures continuity of procedures from year to year.

However, this has led to an internal weakness. Because the existing staff is thoroughly versed in procedures, only a limited number of agencies have written procedures manuals. Consequently, when personnel leave, the transition for a new staff member is more difficult than necessary. The loss of a staff member who performed external and internal management reports can be particularly troublesome if specific procedures for developing statistical and performance data were never passed on to the replacement. This affects the accuracy and credibility of the reported numbers.

8. Staff Qualifications

Administering a guarantee agency requires skilled management which can keep up with the changing environment in which the guaranteed student loan program operates. Agencies which administered their own programs needed qualified supervisory personnel with the following skills:

a. Experience in the banking/lending community;

b. Financial and accounting background with a good understanding of financial reports;

c. Ability to work with state legislators, state agencies and the U.S. Office of Education;

d. Knowledge of data processing;

e. Collections experience (if an in-house effort is undertaken); and

f. Knowledge of all forms of student financial assistance.

V. OPERATIONS

A. INTRODUCTION

The purpose of this chapter is to summarize certain findings and conclusions with respect to the operations performed by guarantee agencies. The purpose of our study was to assist non-agency states to develop agencies in the most efficient and cost effective manner. No attempt was made to render formal evaluations of the operations of existing agencies. This chapter does, however, contain what we believe are the effective practices which an agency should consider when establishing its operations.

We believe that the top management at most established agencies would benefit from a careful reading of this chapter. We also would be pleased to speak with any agency director in order to interpret the conclusions and recommendations of this chapter in the context of a particular agency's situation as we saw it while doing on-site data collection and analysis.

For purposes of data collection, agency operations were divided into functional categories. Agency practices, costs and staffing were allocated and analyzed in terms of each of the functions described below.*

- Loan Approval

  All guarantee agencies perform certain activities related to this function. The purpose of this activity is to verify whether the lender, the school and the student meet the eligibility requirements for a guaranteed student loan. If so, the loan is guaranteed (i.e., insured).

- Essential Loan Servicing

  The agencies must maintain records on the loans which they have guaranteed. There is great diversity in terms of the accuracy and type of data maintained by the guarantee agencies.

---

* The specific activities performed as part of these functions are described in detail in Appendix C, GUARANTEE AGENCY FUNCTIONS.

- Special Loan Servicing

  In addition to record maintenance, agencies may perform special services for lenders. Examples of such services include billing the Office of Education for interest and providing updated student status information to lenders on a regular basis.

- Preclaims Assistance

  All agencies currently offer this service to lenders. If a student becomes delinquent, the lender can contact the agency for assistance. The agency then would attempt to contact the student in order to get the student back on repayment and prevent a default.

- Claims

  When the lender files a claim, the agency reviews it and reimburses the lender. The agency would then file a reinsurance claim with the Office of Education. The agencies vary with respect to the speed and willingness with which they purchase claims.

- Collections

  Once a claim has been purchased, the agency will attempt to collect from the defaulter, possibly through the use of a commercial collection agency or through legal resources.

- Regulation and Compliance

  The Federal regulations for the Guaranteed Student Loan Program are complex and constantly changing. Lenders, schools and students need to be notified of any changes, and the guarantee agency needs to be aware of any compliance problems. In addition to Federal regulations, the guarantee agency may have additional state-specific regulations.

- Lender Promotion

  Commercial lenders are the primary source of loan capital for the Guaranteed Student Loan Program. The guarantee agencies have developed a variety of practices designed to recruit new lenders into the program and to service active lenders in the program.

- School Liaison

  The agencies disseminate information on the nature and requirements of the guaranteed loan program to students through financial aid officers. The primary means of contact is through periodic group workshops at which several schools are represented. These workshops are sometimes supplemented by on-site campus visits by members of the agency staff.

The remainder of this chapter is organized into four sections: Loan Processing, Claims and Collections, External Relations and Servicers.

B. LOAN PROCESSING

There are three interdependent functions included within Loan Processing: Loan Approval, Essential Loan Servicing and Special Loan Servicing. Loan Approval begins with the receipt of a guarantee application and ends with the establishment of a loan record. Essential Loan Servicing consists of the record maintenance activities performed by guarantee agencies.

Servicing activities outside of minimum record maintenance are included within the category of Special Loan Servicing.

These functions are interdependent. Essential Loan Servicing is dependent upon the establishment of an accurate loan record as a result of the Loan Approval process. Special Loan Servicing (e.g., interest billing) is dependent upon the basic record maintenance activities of Essential Loan Servicing (e.g., recording the conversion of a loan from interim to repayment status).

1. Loan Approval

The objectives of this function are the following:

- To ensure that loans are in compliance with all Federal and agency regulations (i.e., are eligible for insurance); and

- To notify lenders of the issuance of the guarantee on a timely basis.

These objectives are, to some extent, in conflict. The more time consumed in reviewing each application for compliance, the more difficult it becomes to generate timely notifications to lenders. In our study we used a standard of seven calendar days as being a reasonable turnaround time for routine applications. (This standard would apply even to the busiest period of the year, July through September.)

Nine of the 14 agencies for which data were available had median processing times in excess of seven calendar days. Agencies which had excessive processing times tended:

- To assign insufficient staff to loan processing;
- To collect and review an excessive amount of data; or
- To develop large backlogs of incomplete or marginally deficient applications which the agency would hold pending resolution by the responsible party.

In an effort to speed the approval process and to increase the effectiveness of reviewing for compliance with regulations, automated loan approval processing has been undertaken by six agencies. In these agencies data is entered into an automated system directly from the application.* The computer system then performs the actual approval process, including the printing of a guarantee notice. However, there does not appear to be any benefit in terms of turnaround time. Exhibit V-1, TURNAROUND TIME (FY77), contains a comparison of median processing times for automated loan approval systems to the median processing times for manual systems. The following conclusions appear warranted:

---

* The alternative is to use loan approval clerks to manually review applications and to check certain information (e.g., amounts of previous loans) against existing records. The clerks approve the loan and issue a notice of guarantee. The information from the loan application may then be entered into an automated file for storage or kept entirely in the form of paper files.

Exhibit V-1
Page 1 of 1

Turnaround Time A/ (FY77)
Automated Versus Manual Loan Approval Processing Systems

	Automated Approval System D/			Manual Approval System		
Annual Volume (Number of Applications Received) C/	Agency	Median Turnaround Time B/ (Calendar Days)	Percentage of Full Time Equivalent Staff	Agency	Median Turnaround Time B/ (Calendar Days)	Percentage of Full-Time Equivalent Staff
0 - 25,000	A	13	12%	F	2	21%
				G	3	21
				H	3	33
				I	5	16
				J	10	32
				K	23	28
25,001 - 50,000	B	13	19%	L	1	15%
				M	21	16
				N	21	27
More than 50,000	C	13	15%	None		
	D	20	16			
	E	23	12			

A/ Turnaround time is defined as the elapsed time in calendar days between receipt of an application and issuance of a guarantee notice to the lender.

B/ Based on a sample of 50 routine loan applications at each agency.

C/ Corresponds to small (less than $15 million annual loan volume), medium ($15 million to $100 million annual loan volume) and large (greater than $100 million annual loan volume).

D/ Data for the sixth agency using an automated loan approval system were not available.

- Automated loan approval systems are used mainly by medium and large agencies.

- High volume agencies (with the notable exception of Agency L) tend to have longer turnaround times than low volume agencies, regardless of whether an automated system is used.

- Manual loan approval systems require a higher proportion of agency full time equivalent staff than do automated systems.

Automated loan approval processing does permit an agency to perform a variety of edits to detect fraudulent loan applications. The agencies in New York, Pennsylvania and Wisconsin have done a considerable amount of work with their computer systems in order to reduce fraud. The primary means used are social security number and address matches.

a. Effective Practices: During the course of our review, we identified certain practices which seemed to increase the effectiveness of a guarantee agency. Those practices which appeared to increase the effectiveness of the loan approval process are described below.

- Application Design

  The applications used by some agencies require data to be submitted which is not required to establish eligibility or to create a permanent loan record (e.g., student grade point average or information on siblings). Agencies which designed their applications to record the minimum data elements needed for agency, lender or Office of Education records tended to spend less time in reviewing applications.

  The application should be designed so that data can be key entered directly from the form. This speeds the process of creating an automated record and of performing automated edits.

- Identification of Problem Lenders and Schools

  Agencies which monitored the performance of schools and lenders (e.g., in terms of compliance with regulations) were able to identify schools and lenders whose applications, based on past performance, should be subjected to more stringent review. This reduced the need to review all applications with equal diligence.

- Consistent Procedures

  Agencies which had established written, consistent procedures for recording loans guaranteed, cancelled, and rejected tended to have more reliable data for purposes of internal and external reporting.

- Cost Consciousness

  Agencies which derived and monitored a cost-per-loan-approved tended to be more efficient in their operations.

- Temporary Staff

  As discussed previously in Chapter IV, several agencies utilize temporary staff to avoid an excessive number of full-time staff on the payroll during peak loan application processing. This is effective provided experienced supervisors are available.

- Minimal Backlog

  During the review process, agencies discovering errors either:*

  - Placed the application in a pending file and sent letters or notices to the responsible party (lenders, students or schools) regarding application deficiencies;
  - Called the responsible party to obtain correct information and made the necessary changes on the application; or
  - Returned the entire application to one of the parties with deficiencies noted.

  Of these methods, the latter two, especially the last one, minimized the agency's backlog and put the burden of correction on the responsible party. However, it is important to consider the percentage of erroneous applications and the nature of the errors when establishing or refining an approach to applications review.

---

* Some agencies used a combination of these procedures.

b. Unit Costs

Economies of scale exist in the Loan Approval function. In general, the larger the number of applications processed, the lower the unit cost as shown on Exhibit V-2, LOAN APPROVAL: COST PER LOAN GUARANTEED (FY77).

The level of automation did not by itself show a significant relationship to unit cost. At a given volume, agencies with manual loan approval processing systems tended to have unit costs similar to those agencies using automated approval systems. This suggests that whatever savings there may be on direct labor in automated agencies is offset by increased spending for data processing services. However, automated systems provide the ability to perform more sophisticated edit checks.

The agency with the lowest unit cost ($1.25) utilized an automated loan approval system which generated notices of guarantee to be sent to lenders. The low unit cost appeared to result not from automation but from a loan approval process which was well-managed, used experienced staff and had consistently applied, written procedures.

The highest unit cost ($13.11) was associated with a small agency which appeared to be over-staffed relative to other agencies of comparable size.

2. Essential Loan Servicing

The objective of this function is to maintain an accurate record on the status of each loan which has been guaranteed by the agency. The effort required to establish and maintain an accurate record is determined by the size of the record (i.e., number of data elements), the frequency of update, the means of update and the type of system being used. The number of items on file is related to the agency's defined needs for their other functions, such as Preclaims Assistance and Collections, as well as for status reports on their portfolio.

4

The manner in which this function is performed affects the ability of a guarantee agency to do the following:

- Accurately determine the outstanding liability in order to establish an appropriate reserve;
- Generate trend data for planning purposes;

Exhibit V-2
Page 1 of 1

Loan Approval: Cost Per Loan Guaranteed (FY77)

Category A/	Number B/	Range	Simple Average
Small Agencies	9	$2.31-$13.11	$7.17
Medium Agencies	6	$1.25-$ 5.13	$3.99
Large Agencies	3	$1.74-$ 3.32	$2.51
	18		

A/ Small = annual volume of less than $15 million
Medium = annual volume of $15 million to $100 million
Large = annual volume greater than $100 million

B/ Agencies using servicers are excluded.

- Demonstrate public accountability by means of reports on the status of the loan portfolio;
- Reduce defaults through effective Preclaims Assistance; and
- Expedite collections on defaulted loans.

Over the life of a loan, the data elements in the loan record are updated and modified as the loan progresses through the in-school period into the repayment period. Information requiring changes in a loan record may originate with the borrower, the school, or a lender. The established agencies varied in their approaches to Essential Loan Servicing with respect to how often loan record data was collected, how much data was collected and how the data was used.

The quality of loan servicing activities (and therefore of the loan records themselves) varies between agencies. Failure to properly service loans already guaranteed contributes to the agency reporting problems which will be discussed below and in Chapter VII.

a. Effective Practices:

- Minimum Number of Forms

  Agencies which minimized the number of forms needed by lenders to update agency records seemed to have more orderly operations and reduced paper flows. If systems are automated, the update form is most useful when the data can be key-entered directly from the form.

- Minimum Number of Data Elements

  Agencies which maintained and updated a minimal number of data elements tended to have more cost-effective operations. Many states had loan records which were very detailed and thus required extensive resources to maintain accurate records.

  The basic minimum data which must be periodically updated would include the following:

  - Borrower Personal Data (e.g., current address);

- Matriculation Status (i.e., in-school, graduated, withdrew); and
- Loan Status (i.e., in-school, grace, repayment, deferred forebearance, paid-in-full, or defaulted).

The source of changes in the loan record data could be the borrower, the school or the lender.

b. Unit Costs

Volume is the primary determinant of unit costs in Essential Loan Servicing. However, economies of scale are somewhat affected by the intensity of the agency's efforts. The more extensive the data maintained and the more frequent the updates, the higher the costs. See Exhibit V-3, ESSENTIAL LOAN SERVICING; COST PER LOAN OUTSTANDING.

The agency with the lowest unit costs ($.20) enjoys economies of scale but also has a lower level of transactions than the other large states. The highest unit cost ($1.51) is associated with a small agency which tends to be overstaffed and has its loan servicing activities inefficiently organized.

c. Loan Balances Outstanding

The maximum liability of an agency is some percentage of the dollar value of loans outstanding.* The dollar value of loans outstanding is the original principal of loans guaranteed minus amounts repaid (including loans paid-in-full, claims, and repayments-to-date of those in repayment).

Only six agencies amortized the principal balance of their outstanding loans. These six were the only agencies which could give some approximation of the unpaid principal balance. The other agencies could only report the original principal of outstanding loans, which overstates the true outstanding balance.

---

* The advent of 100% reinsurance has reduced the need for agencies to maintain high reserves against outstanding loans. However, for purposes of reporting to the public, there may be a need to know the approximate outstanding portfolio balance.

Exhibit V-3
Page 1 of 1

Essential Loan Servicing: Cost Per Loan Outstanding

Category A/	Number B/	Range	Simple Average
Small Agencies	9	$.24 - 1.51	$.73
Medium Agencies	6	$.21 - .78	$.44
Large Agencies	3	$.20 - .35	$.29
	18		

A/ Small = annual volume of less than $15 million

Medium = annual volume of $15 million to $100 million

Large = annual volume greater than $100 million

B/ Agencies using servicers are excluded.

Amortization was approached in the one of the following three ways:

- Amortization monthly of the principal amount with lenders being responsible for informing the agency of non-standard transactions as they occurred;
- Amortization monthly of the principal amount with records reconciled on a quarterly or semi-annual basis by sending computer generated lists to lenders and having them adjust the balances on individual loans as appropriate; or
- Sending letters to the lenders periodically to request the outstanding lender balance on the entire portfolio (not on a per loan basis).

Substantial data processing capabilities are required to use either of the first two approaches. The last approach is the easiest, does not require extensive data processing support, and is probably the least accurate.

3. Special Loan Servicing:*

Special Loan Servicing consists of activities or groups of activities which are optional to a guarantee agency but which can provide a number of benefits to the agency, lenders and the Office of Education. These special services fall into three categories:

- Interest Billing to the Office of Education;
- Lender-Held Loan Servicing; and
- Positive Student Status Verfication.

a. Potential Benefits: The potential benefits of performing special servicing are discussed below.

- Enhanced Lender Participation

  By assuming functions that are usually the responsibility of the lender, lender participation may be enhanced. This is particularly applicable to small lenders which may lack the resources to efficiently manage a guaranteed student loan portfolio.

---

* For a description of the specific activities included in Special Loan Servicing see Appendix C, GUARANTEE AGENCY FUNCTIONS.

- Improved Agency Data Base

  By performing the more sophisticated functions necessary to accomplish special servicing (e.g., maintaining outstanding balances for interest billing), an agency is in a position to be aware of school and lender problems or weaknesses and take steps to correct them.

- Ease of Review

  Special loan servicing centralizes the servicing of loans with the guarantee agencies which become responsible for activities previously performed by lenders. This assists the Office of Education in the performance of its compliance activities since those activities (e.g., review of interest billing procedures) can be focused on a limited number of guarantee agencies rather then spread over hundreds of participating lenders. The agencies are also better able to evaluate due diligence on the part of lenders when the they are responsible for student status verification (or are actually performing due diligence for the lender as part of a lender-held loan servicing agreement).

Although the potential benefits of performing special loan servicing are clear, it should be understood that, to perform such servicing efficiently requires a larger commitment of resources than most agencies can afford. To begin with, any special loan servicing requires extensive data processing support. In addition, staff size would have to be increased.

Performance of interest billing or lender-held loan servicing involves the agency acting as a financial agent for lenders and handling payments for them; this imposes a requirement for a strict set of internal controls and a need for additional accounting support. Even the performance of positive student status verification raises questions as to the proper role for an agency in interposing itself between schools and lenders, both of which have specific obligations under the regulations to maintain accurate matriculation status information on borrowers.

Of the 24 state agencies studied, as of FY77 twelve states peformed no special servicing, ten states provided one of the services, and three states provided two.

b. Description of Special Loan Services

1) Interest Billing

In FY77, Interest Billing was performed by four agencies.* Interest Billing is intended to reduce the administrative burden and costs of participating lenders.

Of the four states performing Interest Billing in FY77, only one offered it as an option. In that case, participating lenders were charged a fee to reduce the cost to the agency of providing the service. In the other cases, it was mandatory for lenders to participate.

Interest Billing requires significant resources on the part of the agency. This is because the agency must maintain accurate loan amortization records and perform a number of reconciliation operations. There is no conclusive evidence that it increases the availability of loan capital.

2) Lender-Held Loan Servicing

This activity consists of the agency performing all functions related to a loan usually performed by the lender, with the exception of holding the note. Some of these functions are listed below:

- Auditing lenders' portfolios for inclusion in the servicing system;
- Maintaining servicing systems and loan records;
- Undertaking student billing for unsubsidized interest;
- Providing billing and payment processing service for loans in payout;

---

* One agency began Interest Billing in FY78. The data from its program is not included in our analysis.

- Performing due diligence on delinquent or defaulted loans;

- Providing reports on portfolio status to lenders; and

- Submitting reports to the Office of Education.

No agency performed Lender-Held Loan Servicing in FY77. One agency began such operations in FY78. Several other agencies mentioned that they were considering initiating this service.

The primary purpose of Lender-Held Loan Servicing was to make the loan program more attractive to lenders by reducing their administrative costs. Some important points to consider are:

- A servicing program is probably more attractive to smaller lenders who lack their own automated systems;

- The program will require a substantial amount of data processing support; and

- The agency will assume responsibility for due diligence (i.e., become responsible for maintaining the integrity of its own guarantee).

3) Positive Student Status Verification

Twelve states performed Positive Student Status Verification which meant that the agency was responsible for notifying lenders of matriculation status changes. This is in contrast to passive status verification wherein schools notify lenders of changes directly.

Positive student status verification was seen by many agencies as an important service to lenders. Because it is a means of identifying students no longer in school, it can be used to identify loans which have failed to convert to repayment status and for which a claim should be submitted.

Positive Student Status Verification consists of:

- Distributing student status verification rosters for direct return to the agency;
- Tracing borrowers whose addresses have changed; and
- Notifying lenders of the status of borrowers.

There are basically two approaches used for obtaining information on student status changes. The first, used in only one state and by United Student Aid Funds, Inc. (starting in FY78), involves sending a mailer to the student for completion, certification and return to the agency. The more common method involves having the schools verify the student's status. In this latter approach, computerized lists are sent to the schools for completion and return.

Many of the agencies experienced practical problems in obtaining reliable and timely student information. Typical problems were as follows:

- Schools often did not return the enrollment lists on time (if at all).
- Agencies lacked sufficient available staff to process the lists in a timely manner when they were received from the schools.
- The above delays led to a number of cases where lenders received notification of changes past the time when the information would have been useful.

The agencies varied in terms of verification frequency and timing. Most verified the status of borrowers in school twice a year.

Lenders were generally appreciative of status verification although some mentioned the practical problems noted above. Status verification could not be correlated with lower default rates, and there was no identifiable effect on lender participation. However, the directors of many agencies indicated a need to perform this service in order to protect themselves against failures by schools to communicate status changes without agency involvement.

Performance of positive student status verification by an agency requires that the process be well planned. Sufficient resources must be assigned to ensure that the lists are distributed in a timely manner, that follow-up occurs with schools which have not returned the lists, that agency records are up-dated and that the information on changes is distributed to lenders.

C. CLAIMS AND COLLECTIONS

As shown on Exhibit IV-1, BASIC GUARANTEE AGENCY ORGANIZATIONAL STRUCTURE, the typical agency has a "Claims and Collections" processing section. Three functions are performed in this section:

- Preclaims Assistance;
- Claims Processing; and
- Collections.

Because these functions are interrelated, they tend to be grouped within a single organizational unit within an agency.

These three functions are performed sequentially on a given loan, i.e., a delinquent loan generates a request from a lender for assistance. It then could become a claim which would be purchased and worked by the agency. The primary objectives of these functions are the following:

1. To prevent a loan from going into default;
2. To pay the claim expeditiously (if preclaims assistance fails); and
3. To recover the defaulted amount from the borrower (if the claim is paid).

Because of the interrelationship of these three functional activities, success or failure in one area affects the results achievable in another. For example, Preclaims Assistance acts as a filter, the purpose of which is to prevent defaults. If the Preclaims Assistance process is not considered important by an agency, or is not managed effectively, potential defaults which should not have reached the claims stage are purchased. These defaults are then relatively easy to collect, i.e., the borrower is responsive regarding his obligation. This can cause the cost of collections to be relatively low on an aggregate basis which gives the collections function the appearance of being highly successful. Therefore, in analyzing the cost and effectiveness of any one of the three functions, one must be cognizant of the relative cost and efficiency of the other two.

Because these functions are interrelated, the management of an agency has some flexibility in employing its resources. Of the three functions, the key one is Preclaims Assistance, which, if successful, precludes the need for the agency to do any further work. Since a Preclaims success rate of approximately 50% appears attainable, agencies should consider employing discretionary resources on the front end of the process (i.e., Preclaims Assistance) rather than on the back end (i.e., Collections). In the long run, the best single way of reducing a collections backlog is to have a tight filter on new claims purchased.

Substantial differences exist in the quality of the records maintained by agencies on their Preclaims Assistance, Claims Processing and Collections activities. This restricted our ability to make interagency comparisons (especially in the critical area of Preclaims Assistance). Furthermore, the guarantee agencies define, organize, emphasize and structure their activities very differently in these three functional areas. Exhibit V-4, RANGE OF PRACTICES: PRECLAIMS ASSISTANCE, CLAIMS PROCESSING, AND COLLECTIONS, shows the range of the industry's common practices from the preferred practices of the better organized and better managed agencies.

1. Preclaims Assistance

The objective of this function is to prevent defaults. Preclaims Assistance is composed of performing skiptracing for borrowers who cannot be located and trying to restore to repayment status borrowers whose whereabouts are known. The primary means of accomplishing these tasks is through phone calls and letters. Some agencies will only send letters, and others only place phone calls. The majority perform both. The recipients of the letters are borrowers, parents, relatives, and co-signers. Form letters are used in some instances. Other means used to locate potential defaulters include accessing state agency records* (e.g., the Department of Motor Vehicles). One agency also sent mail-grams as a last resort in an effort to prevent a claim.

---

* This is an advantage which the private nonprofit guarantee agencies did not enjoy since it is a privilege reserved by most states to state agencies.

Exhibit V-4
Page 1 of 2

Range of Practice: Preclaims Assistance, Claims Processing and Collections

Preferred Practice	Common Practice
PRECLAIMS ASSISTANCE:	
1. Preclaims assistance must be requested by the lender (usually 60 or 90 days after conversion or payment is due).	1. Preclaims assistance is not mandatory (14 out of 24 agencies). Requests for assistance are submitted haphazardly, if at all. The result is that an agency may not know a problem exists until a claim is submitted by a lender.
2. The Agency and the lender pursue default prevention efforts simultaneously (except where prohibited by law).	2. Lender efforts do not continue once Preclaims Assistance has been requested.
3. Assistance includes both writing and calling the borrower and the co-signer (if applicable). Assistance continues until the account is either brought up to date or it is determined that a claim should be submitted.	3. As little as one letter or call is the extent of the assistance. In some cases a series of form letters is sent, but the status of the account is not coordinated with the lender.
CLAIMS PROCESSING:	
1. Claim approval is automatic if Preclaims Assistance has been rendered and the lender's claim submission is complete.	1. Additional agency efforts are expended after a claim has been received although the agency has been working the account as a Preclaims Assistance Request.
2. Claim payment should occur within 30 days of receipt of a claim if Preclaims Assistance has been given.	2. Claims payments are processed slowly, sometimes taking 60 to 90 days. During this period, default prevention activities may or may not be taking place.

Exhibit V-4
Page 2 of 2

Range of Practices: Preclaims Assistance, Claims Processing and Collections

Preferred Practice	Common Practice
COLLECTIONS:	
1. An account is "worked" by an agency according to a schedule and according to written procedure.	1. Account is not worked according to a schedule (some accounts may receive more attention than others). There are no written procedures or guidelines to aid in determining whether referral to a third party is appropriate.
2. If a temporary hardship situation exists, the account is suspended and followed up periodically.	2. If a temporary hardship situation exists, the account is suspended, but there are no procedures to ensure follow-up occurs.
3. If an account appears to be uncollectable it is referred to an appropriate third party such as the following: - Collection Agency; - Attorney General (state agency); or - Outside Counsel.	3. If an account appears to be uncollectable, it is filed and no further work occurs.
4. Referrals to third parties occur after a specific level of in-house effort has occurred (e.g., after 30 days).	4. Referral to a third party occurs randomly after extended in-house effort.

The Education Amendments of 1976 enhanced the incentive of guarantee agencies to undertake default prevention efforts. Specifically, the Administrative Cost Allowance was to be partially based on the expenditures for Preclaims Assistance. The effect was that agencies with existing preclaims services intensified their efforts, and the other agencies began such activities. In FY 77 only one established agency did not perform Preclaims Assistance. This particular agency considered default prevention to be primarily the responsibility of the lender. Consequently, it did not encourage lenders to request assistance.

Although the maintenance of records by agencies on Preclaims Assistance was generally inadequate, it did appear from the results of those states which maintained good records that defaults can be prevented in approximately 50% of the cases referred for assistance. This appears to be a valid performance standard for any Preclaims Assistance program.

A unique characteristic of the Preclaims process is the high degree of interaction between the borrower and agency (or lender) staff. Borrower reasons for nonpayment or nonconversion may range from indifference or hostility to personal emergencies. Because of this, the staff person is called upon to exercise judgment regarding each case, particularly when it appears to be appropriate for forebearance to be granted. Consequently, the quality of Preclaims Assistance is closely related to the personnel involved, the effectiveness of the procedures themselves, and, particularly, to the expertise of the first line supervisors.

Because of the personal nature of the process and the short time frame (30 to 60 days) in which an agency has to work a delinquent loan, Preclaims Assistance does not lend itself to a high degree of automation. Only five agencies had any form of direct computer support for Preclaims Assistance. In those agencies, automated systems provided assistance in tracking the mailing of notices to delinquent borrowers; in two of these agencies the automated system generated form letters.

Probably the most important role for automation in default prevention is to provide the agency's staff and lenders with lists of borrowers who were scheduled to enter repayment but, as of the time the list was generated, had not done so. This alerts the agency and the lenders to potential problems.

The Preclaims Assistance process was initiated by a variety of methods. In eight agencies, the request procedures were not formalized. Lenders could call or write the agency to request assistance. In the other states, forms requesting Preclaims Assistance had to be submitted. In addition, there were varying requirements relative to the timing of requests. Five agencies did not establish specific time requirements. In the remaining 13 states, the timing varied from 30 to 100 days past due for borrowers on repayment and from five to the full nine months for students who had not signed payout notes. Agencies which had mandatory Preclaims Assistance, had communicated definite written procedures to lenders, required early warning of potential defaults and responded aggressively to lender requests tended to have more control over the process and had the potential to prevent more defaults than those agencies which did not have a serious, structured Preclaims Assistance program.

The differing practices were in part due to the different philosophies of agency management personnel regarding both of the following:

- Where the responsibility for default prevention lay (agency or lender or both); and
- The importance of default prevention relative to other agency activities (especially Collections).

The agencies varied in terms of their emphasis on lender diligence in pursuing delinquent borrowers. In a limited number of agencies this led to due diligence regulations not being enforced. In states where there was a high level of concern regarding lender participation and where the agency wished to relieve the administrative burden on the lender, the lender's role tended to be minimized, and the responsibility for default prevention was assumed by the agency. The long run implications of this were usually not carefully considered by agency management.

a. Effective Practices

- Record Maintenance

  In FY 77, only eight agencies maintained records of requests for assistance by lenders, and only five of these maintained the information necessary to compute how often they were successful (i.e., "cured" a delinquency situation and prevented a claim). Without this level of information, the management of an agency has no basis upon which to judge the efficiency of its Preclaims Assistance operation or to plan the allocation of resources between functional activities.

At a minimum, agencies should maintain records of the number of requests received, the disposition of the requests and the elapsed times required to process the requests.

- Skiptracing

  When an agency had access to sources which the lender did not (e.g., Department of Motor Vehicle records), the provision of skiptracing services by an agency was perceived as being beneficial by the lending community. (The provision of such addresses may actually be more effective in terms of securing lender goodwill than in locating borrowers since such addresses can be, and often are, out of date.)

- Lender Coordination

  Agencies which worked in coordination with the lenders to prevent claims appeared to be more effective. Close coordination between lenders and the agency tended to ensure that lenders maintained due diligence activities over the full period of the delinquincy. Coordination here refers to situations with the following characteristics:

  - Lenders are encouraged to report problem cases to the agency early (although notification of the agency by the lender does not relieve the lender of responsibility for due diligence);

  - Lender and agency operating staffs communicate openly and frequently on the status of individual cases; and

  - Lender and agency staffs continue parallel default prevention activities even after the agency has been notified of the need for assistance.

- Personal Contact

  For those agencies where data existed, the agencies which emphasized telephone calls (as opposed to form letters) were more successful in obtaining borrower acceptance of payment responsibilities.

- Multiple "Cure" Tracking

  The nature of defaulters is such that many may be delinquent on their loans several times before being declared in default. The process of "curing" the same loan is expensive and frustrating for the lender. (Only two states tracked borrowers who had previously been through Preclaims Assistance.) There is a need to identify repeaters and to judge if it is worthwhile to buy them as special case problem loans.

6. Unit Costs and Cure Rates

As discussed under Record Maintenance, in FY77 most agencies did not maintain accurate records of the number of requests for assistance and/or the number of successful default prevention efforts (i.e., cures). Only eight agencies maintained records of requests, and only five of these maintained the information necessary to compute a cure rate. These are shown on Exhibit V-5, PRECLAIMS ASSISTANCE: CURE RATES AND UNIT COSTS (FY77).

The scope of agency efforts (e.g. personal contact by telephone versus mailing a single form letter) affected unit costs. The agency with the largest number of requests (45,741) and cures (22,812) had the lowest average unit cost per cure ($22.28) which suggests that economies of scale exist when the volume of requests reaches a certain magnitude. Interpreting unit cost data, however requires some analysis of the due diligence situation prevailing in a given state. For example, low unit costs for cures may result from a lack of due diligence on the part of lenders such that an agency "cures" cases which could have been solved by the lender without agency intervention.

The agency with the best cure rate (56.2%) shown on Exhibit V-5, performed almost all of its Preclaims Assistance activities on the telephone. A delinquent loan was assigned to a specific collector for a two month period (at the end of which the claim was approved for payment if the borrower had not resumed payments). This agency used exhaustive means to trace students whose addresses were unknown. Calls were placed to apartment building superintendents, neighbors and local police departments as part of the tracing process. Given the success rate, this tenacious tracking by telephone appeared to yield results. However, it was also expensive. Exhibit V-5 shows that the most successful agency also had the highest average cost per cure. However, each cure, if permanent, saved thousands of dollars in default and processing costs which

Exhibit V-5
Page 1 of 1

Preclaims Assistance: Cure Rates and Unit Costs (FY77)

Agency A/	Number of Requests	Number of Cures B/	Cure Rate	Average Cost Per Request	Average Cost Per Cure
A	45,741	22,812	49.9%	$12.81	$ 22.28
B	5,012	1,974	39.4	24.08	61.24
C	3,050	NA	NA	9.95	NA
D	2,856	1,349	47.2	19.48	41.25
E	2,046	1,150	56.2	77.89	138.58
F	663	NA	NA	23.65	NA
G	403	NA	NA	24.67	NA
H	108	39	36.1	32.66	90.44

NA = Not Available

A/ Includes only agencies which maintained the required statistical data for FY77.

B/ Includes only agencies which maintained both the number of requests and the number of cures; cures are defined as requests for assistance which do not result in claims (i.e., the default is prevented).

indicates that the investment of substantial agency resources in Preclaims Assistance is worthwhile.

2. Claims Processing

The objectives of this function are as follows:

- To review claims to determine that they are in compliance with Federal and lender regulations (e.g., that due diligence requirements have been met);
- To pay lenders the amounts due on a timely basis; and
- To file for Federal reinsurance on a periodic basis so as to minimize any agency cash flow problems.

After 120 days have elapsed and a borrower has either not resumed or not started repayment, the lender may file a claim with the guarantee agency for the amount guaranteed under the terms of their agreement. There are a number of different approaches to Claims Processing, both in regard to the agency's conception of what Claims Processing should consist of and in regard to specific practices. Some of these differences are discussed below:

- Scope of Review

  Since each day of payment delay after 120 days of delinquency can result in lost lender revenue, timing is a critical element in Claims Processing. Median processing times were available for 14 agencies. They ranged from 14 to 119 days after the claim was received. The simple average was 37 days. (There would appear to be no reason why an agency with a mandatory Preclaims Assistance program should not pay routine claims within 30 days of receipt of claim (i.e., the 150th day of delinquency.)

  A great deal of the variation in processing time can be attributed to differences in the scope of agency activities in the claims review process. In some cases, the submission of the claim form initiates a default prevention process similar to that described above under Preclaims Assistance. This is particularly true of agencies which do not make a lender request for Preclaims Assistance mandatory. These agencies wait until a formal claim is received before attempting to locate and restore delinquent borrowers to repayment. However, by waiting until after the 120th day to initiate these default prevention efforts, the agency reduces its potential effectiveness (which is a function of early involvement in the delinquency period) and potentially alienates the lender who must wait for the default prevention process to run its course before being paid for the claim.

Very few claims are ultimately rejected by agencies. However, most agencies reported that between 5% and 15% of claims are returned to the lender for further work. The reasons for rejection include incomplete claims forms, lack of original note, incomplete documentation of due diligence and incomplete performance of due diligence. When these deficiencies are corrected by the lender, the claim is resubmitted and normally approved.

- Specificity of Due Diligence Requirements

The lender, as holder of the loan, is generally charged with the primary responsibility for performing certain actions to locate delinquent borrowers and to have them resume payment. The requirement is that lenders exercise due diligence in attempting to bring the loan to a current status.

Agencies vary in terms of the specificity of their due diligence requirements. Five agencies required that lenders be as diligent in collecting these loans as they would be with others in their portfolio. One agency had no written regulations. The remaining agencies had written regulations which required specific efforts (e.g., two letters and one phone call).

- Enforcement of Due Diligence Requirements

The degree to which regulations were enforced was difficult to determine accurately. Nevertheless, it was clear that some agencies preferred not to vigorously enforce their due diligence requirements. Others sought 100% compliance. The usual explanation of a failure to enforce due diligence was a reluctance on the part of agency management to enforce requirements which might irritate participating lenders.

a. Effective Practices

- Timely Processing

  Agencies which processed claims quickly tended to have better relations with lenders. (The tradeoff here is between keeping lenders satisfied and ensuring that all claims are legitimate).

- Mandatory Preclaims Assistance

  Agencies which required (and enforced) a mandatory Preclaims Assistance request from lenders tended to have a more efficient Claims Processing operation. This occurred because default prevention efforts by the agency preceded the filing of the claim rather than being conducted after the filing of the claim.

- Written Procedures

  Agencies which had established, written procedures were more likely to have an effective processing function. Errors were minimized, and each claim given the same level of review. As a result, lenders were less likely to find fault with the processing function.

- Enforcement of Due Diligence

  Agencies which have established a reputation for enforcing due diligence requirements spent less time reviewing claims and contacting the borrowers themselves because the lenders had already performed much of the activity. Lenders did not appear to object to the enforcement of a consistently applied set of due diligence regulations which had been distributed and explained to them in advance.

b. Unit Costs

The average cost for the nine agencies which processed less than one thousand claims in FY77 was $27.22 per $1,000 paid. This is approximately twice the cost per $1,000 paid for the nine agencies which processed more than one thousand claims. Consequently, economies of scale appear to exist.

Another factor which appears to affect unit costs is the agency's readiness to purchase a claim. Two agencies with an equivalent claim volume could have widely varying costs depending upon the default prevention efforts made subsequent to the filing of the claims. A high unit cost taken by itself is not necessarily significant since it may indicate processing inefficiencies, extensive default prevention efforts or some combination of the two.

3. Collections

The objectives of the Collection function are to locate defaulters and establish a loan repayment arrangement. The collections function tends to be labor intensive since it requires personal communications between a collector and a defaulted borrower. It also requires certain skills on the part of collectors, accounting support for the collections section, non-standard working hours for the collectors and legal support. Consequently, very few agencies operated their collections function without some form of outside assistance.

Twenty-one agencies (including the five serviced by United Student Aid Funds, Inc.) used commercial collection agencies and/or outside counsel to assist in some aspect of the collection process. Four of these 21 agencies relied almost entirely upon outside firms for collection activities. Three agencies did not make any use of commercial collection agencies or outside counsel.

The usual fee charged by the commercial collection agencies was 30% of the amount recovered. Fees varied depending on the total volume of loans placed, whether it was a first or subsequent placement, and the negotiating expertise of the agency.

The Education Amendments of 1976 stimulated collection activities by the guarantee agencies since the Amendments allowed the agencies to retain up to 30% of the amounts recovered.* This 30% comes entirely from the portion of the recovery due to the Office of Education as a refund of its reinsurance payment. Prior to the 1976 Amendments, an agency had no provision for reimbursement of the costs incurred in the performance of collection activities, but was under an obligation to remit an amount equal to the reinsurance rate* times the amount recovered to the Office of Education; this acted as a disincentive to engage in extensive collection activities.

---

* The agencies may retain the lower of actual unreimbursed cost or 30% of the amounts collected to cover the cost associated with Preclaims Assistance and Collections.

a. Effective Practices

- Commercial Collection Agencies

  Use of outside collection agencies appeared to benefit small agencies which lacked the resources to establish effective in-house collection sections. However, where outside collection agencies were used, some agencies appeared to minimize total collection costs by handling easier cases prior to referral to an outside agency.

- Working Older Claims

  Several experienced collections supervisors maintained that working older claims (subject to restrictions imposed by statutes of limitation) was productive. Three to five years after the default occurred, defaulters, if they could be located, tended to be more vulnerable to legal judgments and adverse credit reports by an agency.

- Credit Bureaus

  By reporting defaults to a credit bureau (preferably a national credit bureau) an agency has the ability to force defaulters to come to terms with the agency in order to secure credit. Several agencies have recently begun to use this approach. While it is too early to identify definitive results, preliminary indications are that the use of credit bureaus is cost effective.

- Legal Action

  Management and collections personnel in several agencies stated that the use of legal action or the threat thereof was a successful means of improving collections effectiveness. The process, however, can be costly and may require the use of outside counsel. Legal action tends also to be effective only in the state in which the action takes place.

---

* For most agencies this was 80%.

- Publicity

  The management of agencies which emphasized legal action and judgments tended to publicize collection efforts. This was done to deter future defaults and to communicate to existing defaulters that the agency was serious in its collection efforts.

- Personal Contact

  Agencies which emphasized personal contact via telephone appeared to be more effective in terms of the amount collected than those which emphasized letters, especially form letters.

- Qualifications of Supervisors

  The capabilities of the collections supervisor appeared to be a critical factor. Substantial experience in the commercial collections field was valuable.

- Garnishment of State Income Tax Refunds

  In the two states where the state income tax refunds of defaulters were garnisheed, the agencies cost per $1 collected was significantly below average. This appears to be an effective means of collecting on the defaulted loans of borrowers who remain in-state without incurring collection agency fees and/or maintaining an extensive in-house collections staff.

b. Unit Costs

Exhibit V-6, COLLECTIONS: COST PER DOLLAR COLLECTED (FY77), compares the cumulative defaults (end of FY77) with the cost per dollar collected in FY77. The results show that economies of scale do exist (i.e., the larger the default pool, the lower the cost per dollar collected).

The two high-cost agencies with costs in the 80-99 cents range were two small agencies which attempted to perform the collections function entirely in-house with minimal staff. The smaller of the two had a collections FTE of 1.4 and total FY77 collections of approximately $22,000 which was

Exhibit V-6
Page 1 of 1

Collections: Cost Per Dollar Recovered

Cumulative Defaults (End of FY77)	Cost Per Dollar Recovered					
	0-20	20-39	40-59	60-79	80-99	Total Number of Agencies
More than $10 million	2	4	0	0	0	6
$1 million - $10 million	0	6	3	0	1	10
Less than $1 million	0	2	0	0	1	3
Total Number of Agencies	2	12	3	0	2	19[A/]

[A/] Includes only agencies for which reliable data were considered to be available; excludes servicer states where collection services are provided by a commercial collection agency to the servicer.

barely in excess of the collection costs incurred. The larger agency had a collections FTE of 2.8 and total FY77 collections of approximately $84,000. The lesson to be learned from these two agencies is that small agencies with relatively low cumulative default pools should seriously consider the use of outside collection assistance rather than begin an in-house operation which can never achieve the economies of scale necessary to be cost effective.

The two agencies with the lowest cost per dollar recovered were large agencies which performed almost all collection activities in-house. The effective practices set forth above were based primarily on the practices of these two states.

It should be emphasized that a very low cost per dollar recovered may not always be a favorable indicator of an agency's performance. Instead, it may indicate that an agency is too quick to buy claims. Several agencies which incurred costs in the 20-39 cents range appeared to have low costs because they were quick to buy claims. In terms of overall costs to these agencies and to the program, they might have had a more effective total performance had they emphasized effective Preclaims Assistance and required stricter adherence to due diligence requirements by lenders.

A low cost per dollar collected may also simply indicate that the agency's Preclaims Assistance is ineffective or is not being used. Similarly, a high cost per dollar collected may be a sign of inefficiency or could be an indicator of a successful default prevention effort by the agency and its lenders so that only "hard core" default claims are purchased.

c. Recovery Rates: A cumulative recovery rate was calculated for each agency for which reliable data were available. These are shown in Exhibit V-7, GUARANTEE AGENCY RECOVERY RATES.

A review of the agencies with recovery rates below 10% shows that they either (1) have a tight filter on claims purchased or (2) have inefficient collections operations. On the other hand, the agencies with recovery rates above 20% tended to buy claims quickly without an extensive default prevention process; for example, the highest recovery rate (30.7%) is that of an agency which does not encourage due diligence by its lenders.

Exhibit V-7
Page 1 of 1

Guarantee Agency Recovery Rates

Recovery Rates *	Number of Agencies**
0-10%	9
10-20%	8
20%+	6
	23

---

* Calculated as follows:

$$\frac{\text{Cumulative Collections (End FY77)}}{\text{Cumulative Default Claims Paid (End FY77)}}$$

** Includes all agencies for which reliable data was available.

Anyone interpreting these recovery rates should keep in mind the qualifications discussed below.

- Lack of Incentive

  As discussed above, prior to the passage of the 1976 Amendments with the 30% retention feature, there was no real incentive for an agency (especially medium and small agencies) to implement a collection effort since it would probably cost money in the long run due to the need to reimburse the Office of Education for 80% of the sum recovered regardless of the costs incurred to make that recovery.

  Since the passage of the Amendments, collection activities have increased. Because our rates are cumulative (i.e., include all defaults and recoveries since the inception of the program), the calculated recovery rates (as of the end of FY77) do not fully reflect these new activities which were just getting started in FY77.

- Conservative Assumptions

  The recovery rates calculated are extremely conservative. "Cumulative Collections" is defined as payments received by the agency. No adjustments are made for loans currently in collection. (A borrower paying $30 per month on a default of $3,000 has only that portion of the principal repaid included in cumulative collections; no adjustment to cumulative collections is made for the balance still due since collection of that balance is uncertain.) Likewise, no adjustments are made to the denominator ("cumulative default claims paid") to reflect any write-offs or any classification of defaulted loans as "uncollectible" since that lends itself to wide ranging approaches anad results in non-comparable results.

  Exhibit V-8, RECOVERY RATE CALCULATIONS, shows the impact on an agency's recovery rate by adjusting the numerator to reflect loans in repayment to the agency and the denominator to eliminate write-offs.

Exhibit V-8
Page 1 of 1

Recovery Rate Calculations
Sample Comparsion

I. CONSERVATIVE APPROACH: NO ADJUSTMENTS

A.	Cumulative Recoveries: (Cash Received)	$ 1,000,000
B.	Cumulative Defaults: (Claims Paid)	8,000,000
C.	Recovery Rate (A÷B):	12.5%

II. ADJUSTED APPROACH

Cumulative Recoveries

A.	Cash Received	$ 1,000,000
B.	Plus: Principal Portion of Loans in Repayment to Agency	1,000,000
C.	Total Recoveries	$ 2,000,000

Cumulative Defaults

D.	Claims Paid	$ 8,000,000
E.	Less: Write Offs	(2,000,000)
F.	Total Defaults	6,000,000
G.	Recovery Rate (C÷F):	33.3%

- **No Cost Adjustment**

  No adjustment has been made to reflect the costs of collection. There is a valid argument that the numerator should contain recoveries net of the costs incurred to make those recoveries (i.e., an agency spending $6 to recover $10 should have only $4 included in the numerator). This approach would measure the efficiency of the collection effort by calculating a recovery rate net of costs. However, cumulative cost data to make this calculation are not available since the agencies had no incentive to maintain cost records prior to the cost reimbursement provisions of the 1976 Amendments becoming effective.

D. EXTERNAL RELATIONS

The primary external constituencies of a guarantee agency are lenders, schools and students. The continued operation of an agency is dependent upon the extent to which lenders supply loan capital in response to student demand. In order to operate effectively, an agency must develop and implement policies which both encourage lender participation and ensure compliance with applicable Federal and agency regulations, two goals which some lenders and some agencies perceive as being potentially in conflict.

As shown on Exhibit IV-1, BASIC GUARANTEE AGENCY ORGANIZATIONAL STRUCTURE, responsibility for external relations is usally concentrated at the level of the agency Director and the Deputy Director. Because of the critical nature of these activities, top management cannot afford to delegate external relations (which in addition to contacts with lenders, schools and students would include contacts with other parties such as state legislators, the press and the Office of Education).

For purposes of this analysis, three functions have been included as external relations. These are the following:

- Lender Promotion;
- School and Student Liaison; and
- Regulation and Compliance.

1. Lender Promotion

The primary objective of the Lender Promotion function is to ensure availability of adequate loan capital to students in all geographical areas of a state through stimulation of lender participation in the program. Lender Promotion consists of two categories of activities: (1) lender recruitment, and (2) lender maintenance. The first activity is generally performed by agency management at the Director or Deputy Director level. This activity involves both recruiting new lenders into the program and encouraging participating lenders to increase their level of participation.

Lender maintenance involves keeping participating lenders satisfied with respect to the level and quality of service by the agency, the perceived profitability of the loans and the availability of agency personnel to answer lender questions. Mature guarantee agency programs, which have achieved participation by a significant number of eligible lenders, tend to emphasize maintenance rather than recruitment.

As part of our study, we conducted interviews of lender representatives in each state where we analyzed the operations of an existing guarantee agency. In general, lenders appeared satisfied with the program and with their relationships with the state guarantee agencies.

a. Effective Practices: The practices described below were identified by lender representatives and agency management personnel as being effective.

- Training and Workshops

  Agencies which offered training sessions and workshops for lenders were more effective in promoting lender maintenance. Agencies which offered to train new student loan employees tended to have close working relationships with lender operating personnel. The periodic personal contacts between agency and lender staffs were an important by-product of these agency training programs and workshops.

- Lender Advisory Councils

  Agencies wherein a lender advisory council existed or where lenders were members of the board of directors were more effective in obtaining lender cooperation and participation.

- Responsiveness

  Agencies which emphasized quick and accurate responess to lender questions at both the managerial and operations level were more successful in keeping the lenders satisfied.

- Prior Banking Experience

  Agencies which employed one or more staff members who had previous experience in commercial lending tended to enjoy better access to, and rapport with, lenders. Previous experience can be especially important for lender recruitment when the agency's contacts are with top lender management.

- Regional Representatives

  Agencies which used regional representatives had better access to lenders and were able to more effectively communicate with lenders. Such representatives were more useful for lender maintenance than recruitment. However, this practice can involve significant costs and should be weighed carefully. (Many small agencies and agencies in geographically compact states did not see a need for regional representatives.)

- Lender Trade Associations and Regulatory Bodies

  Agencies where management maintained close relationships with the state banking commission and with the state bankers association tended to have greater success in securing access to lender top management.

b. Lender Incentives

Four states paid lender incentive fees. The practice of paying incentive fees began in the mid-1960's. At that time the return to lenders was limited to a basic interest rate of 6%. In order to stimulate lender participation, a number of states began to pay lender fees (usually at the time a loan was originated). These fees increased the return to lenders and made guaranteed student loans competitive with other investment opportunities. However, in 1969 the Special Allowance was initiated. Payment of the Special Allowance* reduced the need for state agencies to pay lender fees. None of the new agencies have initiated such fees. We have recommended that new agencies not pay lender fees until it is clear that such fees are required to stimulate lender participation.

Two states offered lenders tax incentives for their participation in the program. In one state, banks were allowed to exclude their student loan portfolio from their assets for purposes of year-end tax determination. In another state, banks were allowed to exclude 50% of their loan portfolio from taxation.

Four agencies in which management had control over investment policy deposited their reserves with lenders. Deposits were usually made with lenders in proportion to their level of participation.

The general level and efficiency of lender services provided by a guarantee agency also constitutes an incentive. This would include the prompt processing of loan guarantee requests and claims, a meaningful Preclaims Assistance program and open channels of communications to knowledgeable agency staff.

2. School and Student Liaison

The major activity of the School and Student Liaison function is communication. The objective is to communicate the following to financial aid officers (FAO's) and to students:

- Responsibilities of Students;
- Responsibilities of Schools;
- Content of Regulations; and
- Availability and Sources of Loans.

---

* Under existing law, the Special Allowance can not exceed 5%. The rate paid is linked to the prevailing rate for 90 day Treasury bills.

As part of our study, we interviewed FAO's at schools in states which had established guarantee agencies. In some states, communication problems did exist. FAO's complained that they were not notified by lenders or the agency about guarantee approvals, loan disbursements and loans going into default. These FAO's objected to being considered as passive beneficiaries of the loan process and felt that they could assist to reduce abuse and prevent defaults by being kept better informed. In addition, many FAO's objected to the number of different application forms received from various states. Some FAO's mentioned that the lenders did not understand the problems of the schools, especially with respect to loan disbursement procedures and verification of student status. Although expressing concern with the debt burden of graduates, the FAO's almost universally acknowledged loans as an essential part of the financial aid package available at their institution.

FAO's in certain states also indicated that some categories of students had occasional difficulties securing loans. The categories most often mentioned were:

- First year students;
- Out-of-state residents;
- Students without prior banking relationships; and
- Students from rural areas where few lenders were participating.

a. Effective Practices

- School Manuals

  Two states published a manual for schools. In both cases, the manual included more than loan program information (e.g., grant program, information, or state direct loan program information), but clearly spelled out the actions required by schools for the guaranteed student loan program.

- Loan Referrals

  Twelve states provided students with some form of referral to lenders.* This activity ranged from providing a list of lenders participating in the program to making referrals to specific lenders.

- Workshops

  FAO's commented that workshops sponsored by agencies (some of which combined lender and school representatives) were useful in clarifying misunderstandings and in opening channels of communication.

- Record Maintenance

  Five states kept records of loan guarantees and defaults by individual school. This information assisted in the agency's liaison and compliance activities.

3. Regulation and Compliance

The Regulation and Compliance function consists of the following tasks:

- Generating and promulgating regulations;
- Developing materials to communicate regulations to lenders and educational institutions;
- Performing compliance activities (e.g., off-site monitoring of performance and conducting on-site reviews to insure that lenders are adhering to regulations); and
- Undertaking to limit, suspend or terminate institutions which have failed to abide by the regulations of the programs.

---

* Our data is based on FY77. We understand that, in response to a request from the Office of Education, more agencies have instituted some form of referral process.

The objective of the Regulation and Compliance function is to ensure that the lenders and educational institutions are abiding by the Federal and agency regulations.

The resources devoted to this function in most agencies were limited. The function is frequently perceived by agency management as being incompatible with Lender Promotion and is valued less than that function. According to this viewpoint, strict compliance policies will tend to reduce the number of lenders willing to participate in the program and to reduce the level of activity of those lenders already in the program. However, we saw no evidence that lenders resented the enforcement of consistently applied published regulations.

Only three agencies performed any type of on-site compliance activity on a routine basis. Others reviewed institutions on an "as needed" basis. These reviews generally resulted from high default rates, student complaints or lack of cooperation on the part of the institution.

Two agencies had "audit" teams which visited the lenders throughout the state. This review process was beneficial for lenders in that it helped them improve their procedures. The audit benefitted the agency in that records were reconciled and improved performance by the lender reduced the workload of the agency.

One agency reviewed the program operation at schools as part of an overall financial aid review. Once again, the goal was to improve operations rather than discover violations of regulations.

a. Effective Practices

- Lender Review Teams

  Use of lender review teams appeared to be one means of promoting compliance and improving the lenders' performance. However, formation and maintenance of such teams may be expensive for an agency. (It is unclear whether the costs of such teams may be reimbursed under the primary portion of the Administrative Cost Allowance as Lender Promotion expense.)

- Contractual Relationship

  Agency contracts with lenders and schools tended to be a mechanism through which to deal with the institutions. The advantages include the legal power and clear definition of responsibilities inherent in a good contract. If the contracts are renewable on a periodic basis (e.g., annually), the agency must provide sufficient resources to process (and, if required) renegotiate the contract renewals.

- Off-site Monitoring

  Agencies monitoring lender and school loan volumes and default rates were better able to anticipate problems before they became critical.

- School and Lender Manuals

  Inclusion of program regulations in the lender and school program manual (with provision for periodic revision as required) assisted the lenders and schools in understanding their responsibilities.

b. Regulatory Process

No clear pattern emerged as to how agencies generated their regulations. Some were more formal than others, and the parties responsible for origination varied widely among agencies. Similarly, the agencies varied in terms of the frequency with which regulations were reviewed and the means of publishing and disseminating new or amended regulations. Some agencies incorporated the regulations in the lender and school manuals which could be revised as needed.

Fifteen agencies had no formal limit, suspend or terminate criteria and procedures. Two others used the Federal regulations, and two more had developed their own set of criteria. Very few institutions have been suspended or terminated in any of the states. Most agency directors without limit, suspend or terminate provisions in their regulations recognized this lack as a mistake, since it curtailed their ability to take independent effective action.

E. COMPREHENSIVE SERVICERS

The term "servicers" can apply to a broad range of organizations which provide services to guarantee agencies. In this sense, commercial collection agencies and data procesing service bureaus are servicers, although the services provided relate to a specific portion of an agency's total activities. Even a state facility (e.g., a state data center) can be considered a servicer to an agency.

For purposes of this section we will address the issues associated with the use of "comprehensive servicers," i.e., private, non-profit corporations which contract to perform the basic processing functions of an agency. During our study we visited six states which utilize such servicers. The servicers and the states are given below:

	Servicer	State(s)
1.	College Foundation, Inc. Raleigh, North Carolina	North Carolina
2.	United Student Aid Funds, Inc. New York, New York & Indianapolis, Indiana	Alaska Delaware Maine Maryland Nevada

The arrangement in North Carolina is unique in the sense that the guarantee agency (North Carolina State Education Assistance Authority) contracts with the College Foundation, Inc. to act as the direct lender for the state, as well as the comprehensive servicer for the agency.

United Student Aid Funds, Inc. (USAF) is the only comprehensive servicer which has contracts with more than one agency. In addition to the five established agencies, USAF also acts as a comprehensive servicer to five new agencies: California, Iowa, Indiana, Utah and the Virgin Islands. Currently, over one-quarter of all existing agencies contract with USAF. The combined loan volume to be processed by USAF in FY80 (approximately $180 million) would make it one of the five largest processors of student loans behind the self-administered guarantee agencies in New York and Pennsylvania and comparable to the agencies in New Jersey and Connecticut which also administer their own programs.

1. Why choose a servicer?

There are three reasons cited by agency personnel for choosing to use a comprehensive servicer. These are the following:

- Provides Fast and Experienced Start-Up

  The start-up period for an agency can be long. We estimate the implementation period for a new agency would require six to twelve months. To the extent a servicer can reduce this start-up period, this can assist a state to have a program in place quickly.

- Avoids State Restrictions on Hiring Additional Personnel

  Use of a servicer does reduce the requirements for agency employees. The established agency in Maryland maintains a small staff (FTE=8) to perform administrative and external relations activities. This is a much smaller staff size than would be required to self administer the program. The new agencies in Indiana, Iowa and California will be similar to Maryland in that the basic processing will be performed by the servicer, while a small agency staff will administer the functions which cannot be effectively delegated to a servicer.

  The ability to minimize the size of an agency's staff by contracting out for processing has tended to be an advantage in developing new agencies in states where the political climate will not allow the creation of a large number of new positions even through the program can eventually be self supporting.

- Can be Cost Effective.

  As part of our effort to assist new agencies we developed a guarantee agency model which projects an agency's sources and requirements for funds. This model shows that a comprehensive servicer tends to be less expensive at low volumes but the cost advantage decreases drastically as volume increases. For example, at a $20 million annual loan volume it appears to be less expensive from the fifth operating year forward for an agency to administer its own program rather than utilize a comprehensive servicer (assuming the servicer charges its fee based on a percentage of loans outstanding*). This has given rise to the "bridge concept" in which a servicer assists an agency to become operational and then reduces the scope of its activities (or terminates them altogether) after the initial operating years.**

2. Services Provided

With respect to Exhibit IV-1, BASIC GUARANTEE AGENCY ORGANIZATIONAL STRUCTURE, a comprehensive servicer would normally provide Loan Processing (i.e., Loan Approval, Essential Loan Servicing, and Special Loan Servicing) and Claims and Collections (i.e., Preclaims Assistance, Claims Processing and Collections). In addition, a servicer would provide administrative support in the area of accounting and management information.

The three functions which are difficult to contract out to a servicer are Lender Promotion, School and Student Liaison and Regulation and Compliance. The activities comprising these three functions require frequent personal contact between the staff of an agency and lenders and schools. This need for frequent personal contact (which is really at the heart of the success of the guarantee agencies relative to the Federally Insured Student Loan Program) is not easily achieved by out-of-state servicers. Based on our observation, we believe the most effective outside servicing arrangement for small or medium-sized agencies would be to use comprehensive servicers to perform the basic loan and claims processing while employing sufficient staff to perform those functional activities best achieved by an agency (i.e., Lender Promotion, School and Student Liaison, and Regulation and Compliance).

3. Program Issues

The role of comprehensive servicers raises some issues for the entire Guaranteed Student Loan Program. Some of these are discussed below.

---

* For purposes of analysis, the servicer fees were assumed to be as follows:
.0075 of the first $2.5 million of outstanding loans;
.0050 of the second $2.5 million of outstanding loans; and
.00375 of all loans outstanding in excess of $5.0 million.

** The bridge concept has a serious weakness in that an agency in its fourth or fifth year of operations will have a large outstanding portfolio to service but will not have any trained processing staff.

Program Identity and Accountability

In three of the USAF states (Delaware, Nevada, and Maine) the role of the state is almost insignificant.* In these three states, the FTE of state personel devoted to the guaranteed loan program is less than one. Lender and school representatives in these states are confused as to the roles of the state and of the servicer; some were not even aware that the state had a role.

The U.S. Congress has emphasized that this was to be a state program. Furthermore, the strength of guarantee agencies has traditionally been based on strong local administration and strong local ties with lenders and schools. The failure of a limited number of states to assume an active role raises questions as to whether the programs in those states really meet the intent of Congress and whether they might be more effective if the responsible state agencies took a more active role in such activities as Lender Promotion, School Liaison and Regulation and Compliance.

Standardization

The use of a servicer provides certain advantages of economies of scale which would otherwise be unavailable to small and medium sized agencies. Economies of scale are available because the servicer uses relatively standard processing procedures and techniques which have the effect of achieving some level of standardization among several state agencies. For example, the basic set of management information reports and the definition of the data elements contained therein tend to be standard for all the states using a given servicer. This can assist in establishing public accountability through the provision of data which is consistent between a set of agencies (as oppposed to the inconsistent data being currently reported).**

---

* The situation is different in Maryland where the guarantee agency maintained a FY77 staff of 8. It is also different in Alaska where the primary source of loan capital is a state direct loan program rather than the USAF program.

** See Chapter VII of this report for more information on reporting problems.

VI. REVENUES AND EXPENSES

A. REVENUES

For the period reviewed (FY77), there were essentially five basic sources of continuing revenues:

- Reinsurance payments from the U.S. Office of Education;
- State Appropriations;
- Insurance Premiums;
- Collections on purchased loans (some portion of which were retained by the agency and the balance forwarded to OE); and
- Investment Income.

Exhibit VI-1, REVENUE PATTERNS (FY77), shows each source as a percentage of total revenues.

1. Reinsurance Payments

Reinsurance payments were received from the U.S. Office of Education. These payments replenished the agency's reserve.

2. State Appropriations

State appropriations can be used for either claim payments or operating expenses. Of the 24 guarantee agencies reviewed, 20 received state appropriations.

3. Insurance Premiums

Insurance premiums could also be used either for operating expenses or to fund a reserve for claim payments. Insurance premiums and state appropriations represented the major sources of revenue for the guarantee agencies. Only four agencies* did not charge an insurance premium; these agencies were completely dependent upon the appropriation process of the state.

---

* These four were Connecticut, Illinois, Louisiana and Tennessee.

Exhibit VI-1
Page 1 of 1

Revenue Patterns (FY 77)

Source	Average A/	Range A/	Number of Agencies B/
Reinsurance Payments From The U.S. Office Of Education	46.5%	4.0% - 73.7%	23
State Appropriations	14.6%	4.2% - 38.5%	20
Insurance Premiums	21.5%	7.8% - 56.3%	19
Collections On Purchased Loans	10.3%	2.7% - 18.6%	23
Investment Income	5.9%	.9% - 31.1%	20
Other	1.2%	.3% - 15.1%	8
	100.0%		

A/ This analysis includes a total of 23 agencies; one agency was omitted because it had a unique funding source which was not comparable to the other agencies. In the range column for any income source, zero entries are not shown. However, the calculation of averages included zeros for any agency which did not receive income from that source.

B/ The number of agencies receiving income from that source; the maximum possible would be 23.

4. Collections

Some portion of the amount collected must be remitted to the Office of Education as reimbursement for the reinsurance paid. The balance is available to pay claims or to pay operating expenses.

5. Investment Income

Income from investments may be available for paying claims or operating costs. The use of investment income from Federal advances resulting from the 1976 amendments is restricted to claims payments.

Income from investments is not a significant source of revenue. Investment income is not more important because investment portfolios for most guarantee agencies are usually limited By the Office of the State Treasurer to low-risk government securities. Four state agencies did not receive any income from their invested funds because such income was retained by the State Treasurer.

6. Other

For FY77, there were two other sources of revenue. One is a miscellaneous category which included services the agency provided for a fee (e.g., Interest Billing) or non-recurring income such as sale of equipment. Only eight agencies had income in this miscellaneous category.

The other source was the Administrative Cost Allowance (ACA). For purposes of our analysis, which was based on FY77, the ACA did not show up as an income source since the Office of Education did not pay any ACA to the agencies in FY77.* Such allowances, under certain conditions, could be equal to 1% of the annual volume of loans guaranteed. These ACA payments will allow guarantee agencies to either expand their operations or reduce their reliance upon state appropriations and/or insurance premiums.

---

* The FY77 ACA was paid to the agencies during FY78.

B. EXPENSES

Expenses for the guarantee agencies were analyzed by:

- Major expense categories (operating expenses, claims, OE reimbursement and other);
- Expense Patterns by Function; and
- Operating Expenses by Line Item.

For analytical purposes, the agencies were categorized by dollar volume of operating budgets.

1. Expense Categories

A guarantee agency has four major expense categories:

a. Operating Expenses

Operating expenses include personnel compensation and other expenses incurred in the day-to-day administration of an agency.

b. Claim Payments

These are payments made to lenders for insurance claims. These payments are made from reserve funds.

c. OE Reimbursement

When agencies collect on defaulted loans, some portion of the amount collected is due the Office of Education.

d. Other

For purposes of our analysis, this category includes nonrecurring expenses, such as the purchase of capital equipment or software development charges.

2. Expense Patterns By Function (Agency Administered Programs)

Exhibit VI-2, EXPENSE PATTERNS BY FUNCTION (FY77) shows the diversity in expenditure patterns encountered at the agencies studied. The patterns reflect both agency capabilities and agency priorities.

a. In general, agencies with larger operating budgets spend proportionately less on Loan Approval, Essential Loan Servicing and Administration.

Exhibit VI-2
Page 1 of 2

Expense Patterns By Function (FY77) A/

Function		Small Agencies B/ (n=8) Range	Average	Medium Agencies B/ (n=8) Range	Average	Large Agencies B/ (n=2) Range	Average
A.	Loan Approval	12.9%-34.2%	21.0%	10.3%-29.0%	17.9%	12.1%-13.3%	12.7%
B.	Essential Loan Servicing	8.0%-19.8%	13.2%	6.4%-16.5%	10.3%	6.1%-10.9%	8.5%
C.	Special Loan Servicing C/	.7% -7.1%	2.8%	1.0%-17.3%	4.9%	.6%-15.6%	8.1%
D.	Preclaims Assistance	1.0%-11.7%	5.6%	.3%-31.9%	10.5%	8.1%-10.2%	9.2%
E.	Claims Processing	3.9%-16.4%	6.6%	4.4%-10.4%	7.6%	5.1%- 6.7%	5.9%
F.	Collections	5.5%-45.2%	20.2%	7.9%-34.2%	22.0%	27.0%-34.0%	30.5%
G.	Regulation and Compliance	.3%-12.7%	4.4%	.8%-6.0%	2.9%	2.6%- 6.2%	4.4%
H.	Lender Promotion C/	1.4%- 7.5%	5.0%	.7%-10.5%	5.4%	3.3%- 4.2%	3.8%
I.	School Liaison	.4%- 6.8%	1.7%	1.0%- 3.2%	2.2%	1.9% -4.6%	3.2%
J.	Administration	13.9%-27.5%	19.5%	8.9%-21.9%	16.3%	7.5%-20.0%	13.7%
			100.0%		100.0%		100.0%

A/ Lender fees have been excluded from this analysis.

B/ For this analysis small agencies are defined as having annual budgets less than $400,000, medium agencies are defined as having annual budgets greater than $400,000 but less than $1 million, large agencies are defined as having annual budgets greater than $1 million.

C/ Includes only agencies which had expenses in that functional area: small (n=7), medium (n=4), and large (n=2).

Exhibit VI-2
Page 2 of 2

Expense Patterns By Function (FY77)

Comparison Of Small Agencies Using Servicers Vs. Self-administered Small Agencies A/

	Self-Administered Agencies (n=8)		Servicer Agencies (n=6)	
Function	Range	Average	Range	Average
A. Loan Approvals	12.9% - 34/2%	21.0%	3.8% - 11.7%	7.2%
B. Essential Loan Servicing	8.0% - 19.8%	13.2%	.6% - 21.5%	13.3%
C. Special Loan Servicing B/	.7% - 7.1%	2.8%	-	-
D. Preclaims Assistance	1.0% - 11.7%	5.6%	2.7% - 13.9%	8.8%
E. Claims Processing	3.9% - 16.4%	6.6%	3.2% - 8.0%	5.8%
F. Collections	5.5% - 45.2%	20.2%	8.9% - 48.6%	25.4%
G. Regulations and Compliance	.3% - 12.7%	4.4%	.1% - 6.8%	2.2%
H. Lender Promotion C/	1.4% - 7.5%	5.0%	.4% - 10.7%	3.8%
I. School Liaison	.4% - 6.8%	1.7%	.7% - 8.6%	2.7%
J. Administration	13.9% - 27.5%	19.5%	18.4% - 69.8%	30.8%
		100.0%		100.0%

A/ Small agencies (self-administered or servicer-administered) are defined for this analysis as having annual budgets less than $400,000.

B/ Includes only agencies which have expenses in this category: Self-Administered (n=7) and Servicer (n=0).

C/ Lender fees have been excluded from this analysis.

Exhibit VI-2
Page 2 of 2

Expense Patterns By Function (FY77)

Comparison Of Small Agencies Using Servicers Vs. Self-administered Small Agencies A/

		Self-Administered Agencies (n=8)		Servicer Agencies (n=6)	
	Function	Range	Average	Range	Average
A.	Loan Approvals	12.9% - 34/2%	21.0%	3.8% - 11.7%	7.2%
B.	Essential Loan Servicing	8.0% - 19.8%	13.2%	.6% - 21.5%	13.3%
C.	Special Loan Servicing B/	.7% - 7.1%	2.8%	-	-
D.	Preclaims Assistance	1.0% - 11.7%	5.6%	2.7% - 13.9%	8.8%
E.	Claims Processing	3.9% - 16.4%	6.6%	3.2% - 8.0%	5.8%
F.	Collections	5.5% - 45.2%	20.2%	8.9% - 48.6%	25.4%
G.	Regulations and Compliance	.3% - 12.7%	4.4%	.1% - 6.8%	2.2%
H.	Lender Promotion C/	1.4% - 7.5%	5.0%	.4% - 10.7%	3.8%
I.	School Liaison	.4% - 6.8%	1.7%	.7% - 8.6%	2.7%
J.	Administration	13.9% - 27.5%	19.5%	18.4% - 69.8%	30.8%
			100.0%		100.0%

A/ Small agencies (self-administered or servicer-administered) are defined for this analysis as having annual budgets less than $400,000.

B/ Includes only agencies which have expenses in this category: Self-Administered (n=7) and Servicer (n=0).

C/ Lender fees have been excluded from this analysis.

b. Spending patterns among all agencies tend to be similar for Regulation and Compliance and School Liaison. This is partially true because economies of scale are not as likely in these areas.

c. In general, small agencies spend proportionately less on Preclaims Assistance.

d. Large agencies devote more resources to Collections than medium or small agencies which are more likely to use collection agencies.

3. Expense Patterns by Function (Servicer Administered Programs)

For purposes of comparison, the expense patterns of agencies using servicers* were compared to those of the small agencies administering their own programs. The results were as follows:

a. In general, a smaller proportion of the operating budget was spent on Loan Approval by states using servicers. This reflects the economies of scale of the servicers.

b. States using comprehensive servicers tend to spend less on Lender Promotion and Regulation and Compliance. These are two functions which are not easily assumed by an out-of-state servicer.

c. States using servicers spend proportionately more on Collections and Administration.

4. Operating Costs

Operating expenses for those agencies administering their own program were divided into eleven categories of expenses. These are shown on Exhibit VI-3, OPERATING EXPENSES.

The single largest component of operating expenses is personnel compensation which ranged on the average from 57.6% in large states to 64.0% in medium-sized states of the operating budgets of the agencies studied.

---

* All six servicer states had annual operating budgets of less than $400,000 and were classifiable as small agencies.

Exhibit VI-3
Page 1 of 1

Operating Expenses (FY77)

	Small Agencies A/ (n=8)		Medium Agencies A/ (n=8)		Large Agencies A/ (n=2)	
Expense	Range B/	Average	Range B/	Average	Range B/	Average
Employee Compensation	38.9%-73.8%	62.1%	56.8%-75.7%	64.0%	53.2%-61.9%	57.6%
Occupancy	2.5%- 8.2%	6.3%	3.4% - 8.1%	5.1%	3.4%- 3.9%	3.7%
Data Processing	1.1%- 9.1%	3.7%	3.0%-20.8%	9.1%	6.8%-13.2%	10.0%
Telephone	.5%- 4.0%	2.1%	.8%-10.2%	3.7%	1.2%- 5.0%	3.1%
Travel	1.2%- 4.3%	2.2%	.4%- 2.0%	1.3%	.3%- .4%	.3%
Professional Services	2.2%-42.4%	13.5%	.7%-17.6%	6.9%	13.4%-13.9%	13.6%
Office Supplies	.6%- 2.6%	1.3%	.4%- 2.2%	1.1%	.2%- 1.3%	.7%
Printing	2.0%- 4.8%	3.1%	.3%- 4.4%	2.7%	1.9%- 2.4%	2.2%
Postage	1.6%- 4.3%	2.9%	2.0%- 7.5%	3.2%	3.9%- 6.3%	5.1%
Furniture and Fixtures	.1%- 3.8%	1.0%	.3%- 3.0%	1.2%	.2%- .8%	.5%
Other	.1%- 3.2%	1.8%	.2%- 4.5%	1.7%	1.2%- 5.2%	3.2%
		100.0%		100.0%		100.0%

A/ For this analysis small agencies are defined as having annual budgets less than $400,000, medium agencies are defined as having annual budgets greater than $400,000 but less than $1 million, large agencies are defined as having annual budgets greater than $1 million.

B/ Includes only agencies which have expenses in this category.

Next to personnel compensation, fees for professional services were proportionately the largest operating cost. These expenditures included legal, accounting and consulting services (except for data processing consulting), as well as services provided by commercial collection firms.

Another significant cost for the guarantee agencies was data processing costs. The average proportion of expenses used for data processing ranged from 4.9% in small states to 10.0% in large states. This category included all data processing costs associated with maintenance and operations. The cost of the agency's own data processing employees are excluded since they have been treated with direct labor costs. However, contract data processing personnel and EDP consulting services would be included in the data processing costs. Equipment lease costs are also included as part of data processing costs, as well as line charges for remote terminals. If the agency owned its data processing equipment, depreciation on that equipment was included as an expense in order that the costs would be consistent with agencies which paid service fees for data processing hardware support.

Occupancy costs were inversely related to the size of the operating budget. Consequently, occupancy represented a larger percentage of the budget in the small agencies than it did for large agencies.

The remaining expense categories each represented less than 5% of the total budget. Telephone costs are largely contingent upon collection efforts and not necessarily related to size of the agency. The proportion of travel, office supplies and printing are inversely related to budget size while the percentage of expenses used for postage is directly proportional. Furniture and fixtures and other expenses do not appear to be related to budget size.

5. Model Operating Expense and Functional Expense Patterns

To illustrate typical expenditure patterns by expense category and by function for small, medium and large agencies, an average operating budget was computed for each agency size category. This budget was then allocated across the expense categories and the functional activities. These models are shown on Exhibit VI-4, MODEL OPERATING EXPENSE PATTERNS (FY77) and Exhibit VI-5, MODEL FUNCTIONAL EXPENSE PATTERNS (FY77).

It should be emphasized that these are illustrative models only and are not suitable for use as budget

Exhibit VI-4
Page 1 of 1

Model Operating Expense Patterns A/
(FY77)

Expense Category	Small Agencies B/		Medium Agencies B/		Large Agencies B/	
	Average C/	($000)	Average C/	($000)	Average C/	($000)
Employee Compensation	62.1%	$109	64.0%	$423	57.6%	$2,288
Occupancy	63	11	5.1	34	3.7	147
Data Processing	3.7	7	9.1	60	10.0	397
Telephone	2.1	4	3.7	24	3.1	123
Travel	2.2	4	1.3	9	.3	12
Professional Services	13.5	24	6.9	46	13.6	540
Office Supplies	1.3	2	1.1	7	.7	28
Printing	3.1	5	2.7	18	2.2	87
Postage	2.9	5	3.2	21	5.1	203
Furniture and Fixtures	1.0	2	1.2	8	.5	20
Other	1.8	3	1.7	11	3.2	127
Total	100.0%	$176	100.0%	$661	100.0%	$3,972

A/ Excludes agencies using Comprehensive Servicers.

B/ Small agencies are defined for this analysis as having annual budgets less than $400,000 (n=8), medium agencies are defined as having annual budgets greater than $400,000 but less than $1 million (n=8), large agencies are defined as having annual budgets greater than $1 million (n=2).

C/ Source: Exhibit VI-3.

Exhibit VI-5
Page 1 of 1

Model Expense Patterns By Function
(FY77)

	Function	Small Agencies A/ (n=8)		Servicer Agencies A/ (n=6)		Medium Agencies A/ (n=9)		Large Agencies A/ (n=2)	
		Average B/	($000)	Average B/	($000)	Average B/	($000)	Average B/	($000)
A.	Loan Approvals	21.0%	$37	7.2%	$15	17.9%	$118	12.7%	$504
B.	Essential Loan Servicing	13.2	23	13.3	29	10.3	68	8.5	338
C.	Special Loan Servicing C/	28	5	-	-	4.9	32	8.1	322
D.	Preclaims Assistance	5.6	10	8.8	19	10.5	69	9.2	365
E.	Claims Processing	6.6	12	5.8	12	7.6	50	5.9	234
F.	Collections	20.2	35	25.4	55	22.0	146	30.5	1,212
G.	Regulation and Compliance	4.4	8	2.2	5	2.9	19	4.4	175
H.	Lender Promotion D/	5.0	9	3.8	8	5.4	36	3.8	151
I.	School and Student Liaison	1.7	3	2.7	6	2.2	15	3.2	127
J.	Administration	19.5	34	30.8	66	16.3	108	13.7	544
	Total	100.0%	$176	100.0%	$215	100.0%	$661	100.0%	$3,972

A/ For this analysis small agencies are defined as having annual budgets less than $400,000, medium agencies are defined as having annual budgets greater than $400,000 but less than $1 million, large agencies are defined as having annual budgets greater than $1 million, all servicer administered agencies have annual budgets less than $400,000.

B/ Averages are taken from Exhibit VI-2.

C/ Includes only agencies which had expenses in that functional area: small (n=7), Servicer Administered (n=0), medium (n=4), and large (n=2).

D/ Lender fees have been excluded from this analysis.

projections. There are a number of variables which may affect the expense requirements for a given agency, such as the following:

- Annual volume;
- Level of servicing;
- Default rate;
- Staff level; and
- Utilization of data processing.

Furthermore, our expenditure data is for FY77 which, because of the impact of inflation, would be inadequate to perform the same activities in FY79.

C. RESERVES

OE requires that an agency identify the specific funds reserved for making claims payments. In addition, many guarantee agencies are required by state legislation to maintain a separate fund for a claims reserve. Three agencies did not identify specific funds for meeting claims payments. In those three states, the state guaranteed that the funds would be available as needed by extending its full faith and credit to the agency's guarantee.

With 100% reinsurance, the need for a high percentage of a claims reserve to outstanding loans is reduced. The main function of a claims reserve is to ease the cash flow needs which arise due to timing differences between the time the agency pays the claim and the time the agency is reimbursed by the Office of Education.

A claims reserve may play an important psychological role. Lenders' confidence in the guarantee program may be linked to the level of the reserve. In general, the small states had larger reserve as a percentage of outstanding loans than large states. The average reserve percentage for small states was 4.6%. It was 3.6% for medium-sized states and, for the one large state which had a reserve fund, it was 2.0%.

D. FINANCIAL VIABILITY*

Guarantee agencies are financially viable. The actual FY77 financial results showed that 21 agencies had total revenues which equalled or exceeded expenses. Three had expenses in excess of revenues.*

---

* For purposes of this analysis, agency revenues and expenses were treated on a cash basis rather than an accrual basis. For FY77, none of the 24 established agencies had a full accrual accounting system.

In order to determine how dependent financial viability was upon state appropriations, the FY77 revenues were adjusted to reflect the following:

- No state appropriations;
- A full 1% Administrative Cost Allowance (ACA); and
- Insurance premiums (for agencies which did not charge premiums).

These adjustments reflect the revenue categories expected by most new agencies.

The adjusted revenues were then compared to the FY77 expenses for each agency. The result showed 19 agencies (of 24) would have had revenues in excess of expenditures. Five agencies, despite ACA payments and imputed income from insurance premiums (where appropriate), would have had expenses in excess of revenues if there had been no state appropriations. This shows that guarantee agencies can be financially viable with the ACA and insurance premium income and without a state appropriation. The fact that guarantee agencies can operate without state appropriations has served as an inducement to states to create guarantee agencies. However, maintenance of financial viability requires careful management of the agency's financial resources and cash flow, as well as careful justification of new services.

---

* One agency had a temporary cash flow problem at year-end because the Office of Education had been slow in making reinsurance payments. Another agency had multiple financial aid programs and did not allocate or control costs on a program basis. The third appeared to be over-staffed relative to similar agencies so that personnel costs were high and efficiency was low.

VII. MANAGEMENT INFORMATION, REPORTING, AND EDP SUPPORT

A. INTRODUCTION

The objective of this chapter is to review our findings concerning agency information systems and agency reporting. We found many guarantee agencies had outgrown their information systems (either manual or automated) and that internal reports were frequently inaccurate and not verifiable by reference to the source data. In some cases, inaccurate internal reports have led to inaccurate external reporting, a problem which has been compounded by a lack of clear guidance from the Office of Education as to what data is to be reported.

B. MANAGEMENT INFORMATION

Guarantee agencies have two types of regular reports:

- Internal management reports which record operating activities (Loan Approval, Preclaims Assistance, Claims Processing and Collections); and
- External reports which are submitted to the Office of Education.

Internal reports are compiled on a periodic basis for the agency's directors and certain supervisors. These reports contain the raw data necessary to prepare external reports.

External reports are submitted to the Office of Education.* The requirements of external reports may affect the content, format and frequency of internal reports. Inaccuracies in internal reports are likely to find their way into external reports.

1. Internal Reporting

Internal reports inform management as to the volume of activities being performed. These reports show activities in a given period (e.g., the current month) and frequently also show cumulative data for the current year and comparisons against previous years and/or planned performance.

---

* External reports may include student status verification reports for distribution to schools and/or summary loan record reports for distribution to lenders.

a. Loan Approvals

The data elements most frequently contained in agency reports were as follows:

1) Loans Guaranteed (Number and Dollars);

2) Number of Borrowers; and

3) Cancellations (Number and Dollars).

Less frequently reported were:

1) Applications Received;

2) Applications Rejected; and

3) Applications In-Process.

Reporting errors occurred because of double-counting applications which had previously been returned for correction, failure to account for partial cancellations, large backlogs of applications held in suspense pending new information, and irreconciliable inconsistencies between manual logs and automated reports.

b. Preclaims Assistance

All but one guarantee agency that we visited engaged in Preclaims Assistance during FY77. Potentially, effective Preclaims Assistance can favorably impact an agency's default rate and save substantial sums in claims payments and subsequent claims processing and collections costs.

However only eight agencies* maintained internal records on the number of Preclaims Assistance requests received and only five of these maintained the information necessary to calculate a "cure rate."**

---

* All data is for FY77.

** A cure occurs where a request for assistance results in the termination of a delinquency through a return to repayment status (i.e., a default claim is prevented).

One error several agencies make is the failure to establish a system to identify delinquencies which had been previously "cured." Such cases may represent borrowers who are not sincere and who are making only sufficient payments to avoid a total default. These cases should receive special treatment for they can represent an irritant to lenders and constitute a compliance problem.

c. Claims Processing

Agencies usually maintained some level of formalized internal reporting on Claims Processing. The data elements most frequently reported were as follows:

1) Number of Claims Received;

2) Number of Claims Paid; and

3) Dollar Payments Made (By type of claim - Default, Bankruptcy, Death or Disability).

Very few agencies aged their claims to determine how long the claims process was taking, even though most agencies had an official policy of processing claims in less than a specified number of working days. Without an aging process there was no way to judge performance relative to policy.

d. Collection Activities

Agencies which maintained in-house collection sections usually had periodic reports on dollars collected.*

However, very few agencies consistently reported the total amounts in collection by such categories as: In Suspense, In Repayment, Actively Pursued, or Uncollectible. Very few agencies had any defined success criteria by which to judge the performance of individual collectors or of the entire collections process.

---

* Those which used commercial collection agencies had access to comparable information from periodic agency reports.

2. External Reporting

Guarantee Agencies submit a number of forms, requests for funds, and reports to the Office of Education. For purposes of our analysis, we focused upon the Guarantee Agency Monthly Report (Form 1130).*

In our visits to guarantee agencies, we found some confusion as to the reporting requirements associated with Form 1130. The major responsibility for the confusion surrounding reporting requirements belongs to the Office of Education. The existing instructions for the completion of Form 1130 are inadequate and lack any detailed definition of the data elements to be reported. The Office of Education has no systematic knowledge of the scope and type of data recorded, maintained and reported by the guarantee agencies. Until recently, no substantive review of the Form 1130 was conducted; it was simply filed away. Consequently, the guarantee agencies have never received any feedback or corrective guidance. Guarantee agencies which are currently reporting inconsistent data believe they are in full compliance with the reporting requirements.

Some responsibility for the situation must also be shared by the guarantee agencies. Both the agencies and the Office of Education have made the act of submitting the Form 1130 an end in itself. OE has not performed a requirements analysis to establish the data necessary to properly exercise their oversight responsibilities, and both parties have lost sight of the need to establish public accountability through a reliable reporting process.

Exhibit VII-2, FORM 1130: REPORTING OF OUTSTANDING LOANS AND CLAIMS PAID, shows the variances associated with reporting outstandings and claims information. As shown on the exhibit, nineteen of the agencies studied reported the original principal of loans outstanding while five reported a declining principal balance. The agencies which reported the original principal balance had no means of determining the unpaid principal balance of outstanding loans. Those agencies which have access to the declining principal balances of their loans are better able to estimate the full scope of their potential liability for purposes of calculating their reserve requirement.

The other element compared on Exhibit VII-2 is claims paid. Seven agencies report the original principal of defaulted loans, eleven agencies report principal and interest paid to lenders, and six agencies report the principal portion of claims paid to lenders.

---

* See Exhibit VII-1 for a facsimile of the Form 1130.

Exhibit VII-1
Page 1 of 1

OE Form 1130

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF EDUCATION
WASHINGTON, D.C. 20202

GUARANTEE AGENCY MONTHLY REPORT
GUARANTEE STUDENT LOAN PROGRAM

FORM APPROVED.
BUDGET BUREAU NO. 51-R0559

NAME OF AGENCY	STATE	MONTHLY REPORT AS OF (MONTH) (DAY) (YEAR)

PART A - RESERVE FUND STATUS RESERVE RATIO ____ TO 1 : REINSURANCE ____ TO 1

1			STATE APPROPRIATIONS AND FUNDS FROM OTHER SOURCES			$
2			FEDERAL ADVANCES			
3			INVESTMENT EARNINGS ON FUND (DIVIDENDS AND INTEREST)			
4			INSURANCE PREMIUMS			
5			FEDERAL PAYMENTS UNDER REINSURANCE OR DEATH AND DISABILITY			
6			TOTAL FUND BALANCE (SUM OF 1 THROUGH 5)			
7	A	1	CLAIMS PAID (AMOUNT PAID TO LENDERS)	$	▨	▨
		2	ADD: ADMINISTRATIVE EXPENSES CHARGED TO FUND	$	▨	▨
		3	SUBTOTAL	▨	$	▨
	B	1	TOTAL RECOVERIES ON CLAIMS PAID	$	▨	▨
		2	LESS: AMOUNT PAID TO OFFICE OF EDUCATION	$	▨	▨
		3	SUBTOTAL	▨	$	▨
8			NET RECOVERIES ON CLAIMS PAID		$	▨
9			NET RESERVE FUND BALANCE (LINE 6 LESS 7(A)(3) AND PLUS 7(B)(3))			$
10			TOTAL LOAN GUARANTEE CAPACITY (LINE 9 TIMES RESERVE RATIO) OR (LINE 9 TIMES REINSURANCE RATIO)			
11			TOTAL LOANS OUTSTANDING			
12			UNUSED LOAN GUARANTEE CAPACITY (LINE 10 LESS LINE 11)			

PART B - PROGRAM OPERATIONS		(I) MONTH OF June 1977		(II) CUMULATIVE FOR CURRENT FEDERAL FISCAL YEAR JULY 1 TO JUNE 30		(III) CUMULATIVE SINCE 11-8-65	
	ITEM	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT
1	APPLICATIONS RECEIVED		▨		▨		▨
2	APPLICATIONS DISAPPROVED		▨		▨		▨
3	LOANS GUARANTEED		$ 500,000		$ 8,000,000		$ 50,000,000
4	LOANS PAID IN FULL		50,000		1,000,000		10,000,000
5	LOANS CANCELED		5,000		60,000		250,000
6	CLAIMS DEATH OR DISABILITY		25,000		120,000		500,000
7	CLAIMS BANKRUPTCY		-0-		60,000		250,000
8	CLAIMS DEFAULT		120,000		875,000		3,500,000
9	(ADJUSTMENTS) (PLUS OR MINUS)		-0-		-0-		-0-
10	TOTAL LOANS OUTSTANDING	▨	▨	▨	▨		35,500,000
11	NUMBER OF BORROWERS		▨		▨		▨

AUTHORIZED SIGNATURE	TITLE	DATE

OE FORM 1130, 5-69 PREVIOUS EDITIONS OF THIS FORM ARE OBSOLETE GSA DC 70-3486

Exhibit VII-2
Page 1 of 1

FORM 1130: Reporting of Outstanding Loans and Claims Paid A/

OUTSTANDING LOANS

Reporting Practice	Number of Agencies
Original Principal	19
Declining Balance	5
	24

CLAIMS PAID

Reporting Practice	Number of Agencies
Original Principal	7
Principal and Interest Paid to Lender	11
Principal Paid to Lender	6
	24

A/ As reported in Part B, Form 1130 (Guarantee Agency Monthly Report).

The following example illustrates the impact of such differential reporting practices. The example assumes that the original principal of the loan is $1,000 and that the borrower, after repaying $200 in principal, defaults on the remaining balance of the loan.

Original Principal	$1,000
Principal Repaid	(200)
Principal Portion of Claim Paid to Lender	$800
Approximate Interest Portion of Claim Paid to Lender*	19
Total Claim Paid	$ 819

Based on the reporting practices of the agencies studied, Data Element B.8 (Claims Default) of Form 1130 would be reported as follows:

$1,000	- 7 Agencies
819	- 11 Agencies
800	- 6 Agencies

The reserve fund status section of Form 1130 is also not consistently reported by the guarantee agencies. The widest variation in reporting appears to be in administrative (i.e., operating) expenses. Very few agencies report their total operating expenses on the Form 1130.

The Quarterly Claims and Collections Report (sometimes called the "Matured Paper Report") is submitted quarterly by state guarantee agencies to the National Council of Higher Education Loan Programs (NCHELP) which in turn submits these reports to the Office of Education. Where the data required by Form 1130 and the Quarterly Claims and Collections Report was the same, we compared the reports to see if identical numbers were reported.

We reviewed the cumulative dollar volume of loans guaranteed (end of FY77) as reported by 19 agencies** on the Quarterly Claims Report against the cumulative dollar volume of loans guaranteed (end of FY77) as reported on the Form 1130. Seven of the nineteen agencies reported different totals. The difference for two was immaterial (less than .2%). However, for the other five the dollar volume on the Quarterly Claims Report varied from that reported on the Form 1130 by .6%, 2.6%, 3.8%, 4.1% and 5.6%.

---

* This assumes a 7% rate of interest accrued for 120 days on the unpaid principal balance.

** Comparable reports as of the end of FY77 were available for only 19 agencies.

Routine loans cause few reporting problems for the guarantee agencies. Most reporting problems are caused by variations from the routine. The following are various typical occurrences which can affect the reporting of a loan once it is guaranteed.

1) When a loan is partially cancelled, reporting practices vary among agencies. Depending on the agency's procedures, a partial cancellation may be not recorded at all or may be included in a summary total of loans paid-in-full.

2) When a portion of a loan is paid off at conversion, some agencies record that information immediately in the paid-in-full section while others do not record the transaction at this time but wait until the balance has been paid off.

3) If there is a default after some portion of the principal has been repaid, some agencies record the paid portion as a paid-in-full while others do not record the information at all.

4) At the time of conversion all loans by a single student are usually converted into one payout note. Therefore, it is difficult for an agency to reconcile the number of loans in repayment with the number of loans guaranteed.

C. EDP SUPPORT

In a typical guarantee agency, there are many factors that indicate a strong need for EDP systems support.

- Volume of Paperwork

  Large volumes of applications and other identical forms are processed by the agency.

- Repetitive Processing Tasks

  Clerical tasks are generally repetitive and performed using a well-defined set of decision rules. In fact, many agencies use temporary employees to perform routine processing during peak periods.

- Long-Term Recordkeeping Requirements

  Many loan guarantees extend ten to fifteen years beyond the original approval date and require almost no updates during that period. Manual file folders require a great deal of storage space and may be easily misfiled.

- Summary Statistical Reports

  For purposes of external reporting and of management decisions, accurate summary data in standard report formats are required. The compilation of such summary statistics is a process which lends itself to automation.

- Record Access

  Although any single record may not be accessed often, when the record must be accessed it should be available promptly and with some assurance that it is accurate. This is easily achievable in a small manual system, but, as the number of records increase, it becomes more difficult to accomplish.

There are also changing conditions in the operating environments of the guarantee agencies that make it desirable to develop effective EDP systems. Many agencies have found that their attempts to expand are stifled by increased clerical salaries or personnel hiring freezes imposed by state governments. These factors will continue into the foreseeable future and must be considered in any plans for guarantee agency activities. EDP systems cannot eliminate the need for clerical staff, but an effective computer system can reduce the staffing growth rate required in an expanding agency.

Increasing requirements for reporting and continuing legislative interest in student loan programs demand that a guarantee agency be prepared to report on its activities and its portfolio. Without the flexibility that can be provided by an automated system, guarantee agencies may be unable to respond adequately to questions. Manual recordkeeping systems are difficult to use for researching general portfolio questions or overall trends. An automated system can be designed to provide the capability for most information requests if the necessary data is available in the automated files.

The considerations described above lead to the conclusion that guarantee agencies have a requirement for EDP systems if they can be acquired for a reasonable cost and are developed to meet each agency's specific requirements.

Some agencies view the computer as an automated recordkeeping device and have developed a system that takes advantage of the computer's ability to store information over a long period of time and to prepare accurate reports. In these agencies the focus is on preparing input for the computer and ensuring that accurate information about agency activities is entered into the system.

Other agencies recognize that the computer can actually perform a portion of the agency's work. For example the computer can be programmed to compare information entered from an application against previous borrower information (e.g., the cumulative total of previous loans). Consequently, computer processing can result in faster guarantee approvals since less manual review is required. The key factor is the emphasis on using the computer as part of the processing instead of using the computer solely as a recordkeeping device. Examples of how a computer can assist a guarantee agency in accomplishing its work include:

- Review of guarantee applications;
- Preparation of student status verification reports;
- Identification of unconverted loans;
- Preparation of reports to the Office of Education;
- Billing of defaulted borrowers;
- Maintenance of accurate accounting records; and
- Monitoring of school and lender default performance.

1. Computer Hardware Support

EDP systems in the existing agencies can be viewed in terms of three components: computer hardware, computer software and staffing for computer support. There are a variety of sources for each of these components and combinations of the sources exist in the agencies. Exhibit VII-3, GUARANTEE AGENCY HARDWARE SUPPORT, details the source of computer hardware resources for the established agencies. "Computer hardware" is defined to mean the data processing equipment that is primarily used to process guarantee agency information. The term "hardware" does not include peripheral equipment such as keypunch machines, terminals or remote printers.

There are four sources for computer hardware support:

a. State Operated Computer Facility

This source of support is most common in states where the agency is part of state government. The state may have a central computer facility for all state data processing needs or the department of state government that includes the guarantee agency may have its own computer.

b. Privately Operated Computer Facility

This category includes those agencies that contract directly for computer hardware support but not those that receive computer services as part of an overall servicer arrangement.

c. In-house Computer Facility

This category includes the guarantee agencies that control and operate their own computer equipment within the agency.

d. Servicer Organization

This category includes those agencies that contract with a comprehensive servicer for all agency functions. In this case EDP hardware support is provided by the servicer as part of the overall contract.

Those states with entirely manual systems are included in the category of "none."

Exhibit VII-3 indicates that twelve of the guarantee agencies used state operated computer facilities. The major reason for this is the economies of scale realized when hardware resources are centralized. Additionally, most states have very restrictive administrative regulations about the acquisition of computer hardware or services. This has precluded many agencies from contracting with privately owned facilities or acquiring mini-computers.

Exhibit VII-3
Page 1 of 1

Guarantee Agency Computer Hardware Support

Source of Support	Large Agency B/	Medium Agency B/	Small Agency B/	Total
State Operated Facility	2	5	5	12
Privately Operated Facility	0	1	0	1
In-house Facility A/	1	0	1	2
Servicer Facility	0	1	5	6
None C/	0	0	3	3
Total	3	7	14	24

A/ In one agency some hardware support is provided by a minicomputer owned by the agency, but the primary support for that agency is provided by the state data processing center.

B/ Categorization is on the basis of the dollar volume of loans guaranteed in FY77: Small is less than $15 million; medium is $15-100 million; large is more than $100 million.

C/ Manual systems only.

2. Computer Software Support

The computer programs designed to fill guarantee agency requirements are called "computer software." Each guarantee agency has developed its own version of computer software with very little coordination or sharing between agencies. The organizations responsible for developing the initial computer software in each guarantee agency varied. The organization providing hardware support is not necessarily responsible for software development, but the hardware support organization is frequently responsible for maintaining the computer software after initial development. For example, in many agencies, the initial computer system was developed by a private contractor but is maintained by state employees.

Each guarantee agency we visited which had an EDP system in place had developed that system specifically for its own use. Even though there are many similarities between the various computer systems, we did not observe any agency that had been able to take advantage of another agency's software development efforts.

3. Computer Staff Support

Only in the largest agencies were there staff assigned specifically to the data processing function. In most other cases, the agency director or the manager of operations was responsible for coordinating data processing support. Although this can be a satisfactory arrangement, it puts the guarantee agency at a disadvantage when data processing requirements change and some modifications are required. The agency must rely on the advice of their support facility which may not fully understand their needs.

VIII. DEFAULT RATES

A. INTRODUCTION

Default rates have been the subject of considerable attention in both the Federal and state loan programs. Default rates have been used as measures of performance of the guaranteed student loan program. Use of default rates as performance measures has certain weaknesses:

- Variables beyond the control of agency management have a significant impact on default rates.
- Low default rates may reflect low availability of loans which is not the intent of the program.
- Cumulative default rates are historical and may not reflect the activities or philosophy of the current management.

Furthermore, calculation of default rates is complicated by the data problems discussed previously in the section of this report entitled "External Reporting." For purposes of our analysis, adjustments in the reported data were sometimes required.

B. DEFAULT RATE CALCULATIONS

Any discussion of default rates must necessarily start with a description of the various means of calculating these rates. There is no single approach to default rate determination that is universally accepted as the correct one by all parties. The result is that comparisons of default rates between agencies and between the Federal and the state programs have frequently been done on the basis of inconsistently calculated rates. There have also been problems in comparing default rates at different points in time for the same program (e.g., as of the end of FY75 versus the end of FY78) because of inconsistent calculations. As a result of congressional and public sensitivity to default rates, there can be an incentive to define the numerator and the demominator in such a manner as to minimize the rate reported publicly.

1. Cumulative Default Rates

Default rates are cumulative in nature. They represent the historical default experience of a particular guarantee agency. The analyses we performed used data which was as of the end of FY77.

a. Denominator (Matured Paper)

The denominator for the cumulative default rate calculation is Total Matured Paper. This represents the original principal of all loans which have entered repayment. Total Matured Paper includes loans which have previously defaulted or have been paid-in-full. It represents the total amount of loans which were eligible to default. Since the default rate is cumulative, Total Matured Paper increases over the life of an agency.

b. Numerator

For purposes of our analysis, the numerator is Total Default Claims Paid. This approach isolates claims which agencies and lenders may have had some ability to control. These are also the claims at which collection activities are directed.

Total Default Claims Paid should be the principal portion of the claims paid to lenders. Because some agencies do not maintain separate records of the principal and interest portions of claims paid, the numerator in the default rate calculations for some agencies included interest. This resulted in minor overstatement of the default rates of some agencies.

A variation of the above approach is to include Total Bankruptcy Claims Paid with Total Default Claims in the numerator. To a limited degree, Bankruptcy Claims can also be controlled by agencies and lenders.

Besides defaults and bankruptcies, lenders are also insured against death or disability on the part of a borrower. Death and disability claims are the result of events which are beyond agency and lender control. Consequently, it would be inappropriate to include this category of claims in the numerator.

2. Office of Education Reinsurance Trigger

The Education Amendments of 1976 specified that an agency could be reinsured for 100 percent of the annual amount of losses incurred in discharge of its insurance obligation. This would occur only so long as the amount to be paid as reinsurance is equal to or less than 5 percent of the original principal amount of insured loans which were in repayment at the end of the previous fiscal year.* The number resulting from this calculation is referred to here as the "reinsurance trigger."

The reinsurance trigger concept is not as meaningful a measure of default rates as the cumulative methods. The first weakness of the "trigger" as a default rate is that it utilizes an annual numerator (claims filings**) with a cumulative denominator (dollars in repayment). The second shortcoming is that the "trigger" favors agencies with older programs since their larger amounts in repayment tend reduce the size of the resultant percentage.

3. Defaults at Conversion

A useful measure of current agency performance relative to defaults would be the proportion of loans scheduled to convert in any one year which defaulted at conversion. Although very few agencies were able to provide this data, it would, if available, show an agency the trend of its default experience since a significant portion of all defaults occur at conversion. This approach would also eliminate the cumulative aspects of the other calculations described above.

C. DEFAULT RATE ANALYSIS

Twenty-two agencies were used in the analysis. Two agencies were excluded either because data was not available or not comparable. Exhibit VIII-1, CUMULATIVE DEFAULT RATES, shows the ranges and averages which were calculated for the guarantee agencies as of the end of FY77. The default rates which we calculated were conservative. No adjustments were made to reflect any of the following:

- Collections;
- Loans currently in repayment to an agency;
- Loans written off; or
- Loans in litigation.

---

* If the calculated percentage exceeds 5 percent but is less than 9 percent, reimbursement would be at 90 percent on the excess over 5 percent. If the calculated percentage exceeds 9 percent, reimbursement would be at 80 percent on the excess over 9 percent.

** Default claims only.

Exhibit VIII-1
Page 1 of 1

CUMULATIVE DEFAULT RATES
(End of FY77)

	Total Default Claims Paid A/	Total Default and Bankruptcy Claims Paid B/
Range:	2.2 - 12.7%	2.5 - 13.2%
Simple Average: C/	7.1%	7.6%
Weighted Average: D/	9.8%	10.3%

A/ Calculated as follows:

$$\frac{\text{Total Default Claims Paid}}{\text{Total Matured Paper}}$$

B/ Calculated as follows:

$$\frac{\text{Total Default + Bankruptcy Claims Paid}}{\text{Total Matured Paper}}$$

C/ Equals the sum of individual agency rates divided by the number of agencies (22).

D/ Equals the total claims paid by all agencies (22) divided by total matured paper for all agencies.

Certain problems and inconsistencies exist in the reporting of data upon the OE Form 1130 (Guarantee Agency Monthly Report) and upon the Quarterly Claims and Collections Report. Chapter VII of this report describes in more detail the reporting problems encountered. Because of such problems, we were sometimes required to adjust the reported data in order to arrive at more consistent default rate calculations. We did this by cross-referencing available internal and external reports for each agency to arrive at figures which we felt were consistent with comparable numbers from other agencies.

1. Limiting Factors

One factor which requires clarification is the existence of a time lag effect. Since we analyzed cumulative default rates, it is difficult to determine whether relatively new agency practices, such as aggressive default prevention efforts, will have a significant effect on the cumulative default rate. Even if these efforts had immediate impact, several years of improvement would be required before a significant impact on the default rate could be identified.

In addition, certain factors which may play a large role in default rate determination are not easily quantifiable. Some of these factors are such things as the nature of relations between lenders and the agency and attitudes of the lender and agency management toward loan access.

Certain significant factors affecting defaults are external to the guarantee agency. For example, the demographic characteristics of the borrower population probably have a significant impact on the default rate.

2. Analysis of Variables

No single factor could be identified as the major determinant of default rates. It seems likely that a set of variables working together account for an agency's default rate. Although, we believe that a guarantee agency can control its defaults within certain limits, it is the interaction of agency practices with certain variables beyond the control of the agency which ultimately determine the agency's default rate.

a. Several variables were related to the cumulative default rates to determine if there were any discernible pattern. These variables included:

1) Agency Practices (e.g., Student Status Verification and Preclaims Assistance);

2) Annual Volume (i.e., agency size);

3) Organizational Structure; and

4) Use of Servicers.

No single variable listed above was found to have a significant relationship with the default rate.

b. Cumulative default rates appeared to be related to the number of loans guaranteed in a state as a percentage of state residents enrolled in postsecondary education. Although the analysis showed an apparent tendency for default rates to increase as the supply of loans (relative to enrollment) increased, the results were not definitive.*

D. PERSPECTIVES ON DEFAULT RATES

1. Agency Policies and Lender Actions

It is important to note that defaults are affected also by actions of the lenders who are themselves influenced by the policies of the guarantee agencies. For instance, in states which have previously reinsured their lenders at less than 100 percent, the cumulative default rates seem to be lower. There appear to be two reasons for this. First, it is likely that lenders would have been more discriminating in approving loans. Second, they would have worked a delinquent loan longer and harder before (if ever) filing a claim.

Our interviews with lenders led us to believe that the attitudes and actions of the agency impacted on the attitudes and actions of lenders. If a state strictly enforced due diligence requirements, lenders appeared willing to work harder to avoid claims.

---

* The data used for the analysis was for FY76 because more recent enrollment data was not available. Since the availability of loan capital has increased since FY76, more current enrollment data might show a clearer relationship between default rates and loan supply.

2. Approach to Access

Distinct differences exist among agencies in regard to their goals. At one end of the spectrum are the agencies that strive to make loans as universally and easily accessible as possible. Their concern for default rates is secondary. At the other extreme are those agencies whose goal is to keep the agency's default rate as low as possible. Default rates cannot be interpreted accurately without understanding the goals of the agency.

3. Conclusion

A number of variables external to the agency and its lenders affect the level of the default rate in a state. These factors play an important role in the state's default rate experience. Examples of these factors include the state's demographic characteristics and the relative emphasis on the desirability of higher education in the state. Within the parameters established by these external factors, a guarantee agency can affect its default rate through effective management and default prevention practices.

RECOMMENDATIONS

IX. SUMMARY OF RECOMMENDATIONS

The recommendations given below are intended to assist representatives of states which are considering the creation of a guarantee agency and/or which are planning the implementation of such an agency.

The recommendations are organized into two phases, evaluation and implementation. The former constitutes the period during which available options are being evaluated and the issues studied. The latter is the period subsequent to a firm decision to proceed with the development of an agency; this phase terminates with the guarantee of the first loan.

A. EVALUATION PHASE: Policy Issues

A-1 States considering the creation of a guarantee agency should utilize a "task force" approach to study the issues.

A medium like a task force (i.e., a study group) is an ideal way in which to bring together individuals with diverse skills from each of the constituencies having an interest in student loans. These constituencies include the lending community, the Governor's office, state legislators, state budget analysts, state educational policy makers and students. Guaranteed student loans involve many complex issues which each constituency will view from a different, but relevant perspective.

Another advantage of the task force is that this approach assists in building the political consensus necessary to move recommendations through the executive and legislative branches of state government.

The size of the task force must be kept to a manageable number, funding must be provided, and a firm schedule set and met. The task force needs staff support to develop alternatives and do the basic research work.

A-2 The issues of loan availability and default rates should be included within the scope of the study.

Loan availability (i.e., the supply of loans) and default rates are related issues. There would appear to be a tendency for default rates to increase as access to loans increases.

The task force should understand that some level of default is inevitable. The attainment of a zero default rate could only be accomplished by restricting access to loan capital to all but a small segment of the otherwise eligible pool of student borrowers. This approach would, however, defeat the purpose of having a guaranteed student loan program.

The practices, procedures, and policies of a guarantee agency have some effect on the default rate. The guarantee agency must function to keep the default rate at an acceptable level in the context of the political and social environment of the state in which it is operating.

A-3 New Agencies should concentrate upon developing support among lenders and upon developing basic processing efficiencies rather than attempt the early introduction of sophisticated lender services.

New agencies will tend to enter a "honeymoon" period in which lenders who may have had some problems with the Federally Insured Student Loan Program are willing to give a new agency the chance to prove what it can do. This provides a new agency with the opportunity to establish support through the provision of basic services (e.g., expeditious handling of inquiries and quick turnaround of requests for loan guarantees).

A-4 In most states the bulk of the financial burden of the program should be borne by borrowers in the form of insurance premiums.

Insurance premiums constitute user fees paid by the borrowers to avail themselves of the agency's guarantee. Without that guarantee, it is unlikely that borrowers would have access to private capital on favorable terms. Therefore, it would seem appropriate that those who enjoy the benefits of the program should be primarily responsible for paying operating expense and building a reserve from which to cover future defaults.

A-5 The initial strategy for new agencies should be to keep insurance premiums high.*

Until an agency is confident that its cash flow is sufficient to cover the current and planned operations, the premium charges should be put at the legally permissible one percent per annum of the original principal balance for the in-school and grace periods.

---

* The same logic applies to the payment of lender fees which should not be initiated by a new agency until it is clear that such fees are required to stimulate lender participation.

The premium will be difficult to increase once it has been established. It will always be acceptable to decrease the premiums at a later point in time if it is established that the original level is not required.

B. EVALUATION PHASE: Financial Issues

B-1 New agencies should establish policies which qualify for 100 percent reinsurance.

The requirements to qualify for 100 percent reinsurance are set forth in Section 177.37 (Supplement Federal Reinsurance) of the Guaranteed Student Loan Program Proposed Regulations (April 5, 1978). They are as follows:

1. Insuring loans up to $2,500 for undergraduates and $5,000 for graduate and professional students;
2. Insuring not less than 100 percent of the unpaid principal of the loan balance;
3. Providing no restrictions on the insurance of loans to state residents who are attending schools outside the state;
4. Providing no more onerous restrictions on school eligibility than those imposed under the Federal Insured Student Loan Program unless a school's eligibility has been limited, suspended, or terminated by either the Office of Education or the guarantee agency or there is a State constitutional prohibition affecting the eligibility of the school;
5. Approving school lenders under reasonable criteria (subject to approval of the Commissioner); and
6. Making an annual report to the Commissioner of Education on criteria, procedures and actions with respect to school lenders.

Existing agencies which have qualified for 100 percent reinsurance have not found these requirements to be particularly burdensome. Potential problems with school lenders have been controlled through a combination of forcing school lenders to meet minimum criteria to qualify, annual renewal of eligibility and close monitoring of volumes and defaults associated with school lenders.

B-2 New agencies should seriously consider establishing policies which qualify for the full one percent Administrative Cost Allowance (ACA).*

To receive the first one-half of one percent (the "primary allowance"), an agency must sign a basic reinsurance agreement (80 percent) with the Office of Education. The ACA is based on costs incurred, and the primary allowance involves a requirement that costs be incurred in certain specified proportions for Lender Promotion and Preclaims and Collections.** New agencies should plan their expenditure patterns and collect costs so as to qualify for the primary allowance.

To receive the second one-half of one percent ("the secondary allowance"), an agency must have entered into a supplemental reinsurance agreement (100 percent). Furthermore, an agency must agree to guarantee loans for students who are not residents of the state who are attending eligible in-state schools. This requirement does not require lenders to make such loans, only that the agency guarantee them if made. Consequently, many established agencies have been satisfied to leave the lending decisions to their lenders and have agreed to guarantee loans to out-of-state residents attending qualified in-state schools.

B-3 Planning for new agencies should consider the financial and administrative implications associated with the continuance and with the termination of the Federally Insured Student Loan Program (FISL).

Under existing regulations, a new agency has the following alternatives available:

---

* The ACA is based on a percentage of the total dollar volume of loans guaranteed in a year.

** For new agencies the requirements as a percentage of the primary allowance are as follows:

	Year 1	Year 2	Year 3	Subsequent Years
Lender Promotion	25%	25%	25%	25%
Preclaims & Collections	0	20	20	50
Other	75	55	55	25

1. Continuance: To allow borrowers who started under FISL to continue to have new loans (if any) guaranteed under FISL; or

2. Termination: To discontinue FISL immediately so that students who have FISL loans would have any new loans guaranteed by the new state program.

Termination increases the new agency volume (and therefore its workload and premium income) and increases the possibility of qualifying for more than the minimum $50,000 Federal advances for each of the first five operating years. Continuance eases the burden on lenders and students by avoiding a situation in which an individual borrower may have different guarantors if more than one educational loan is obtained.

A decision in this area requires an analysis of the financial and operating impact of each alternative, as well as some input from lenders in the state.

C. EVALUATION PHASE: Organizational Issues

C-1 The cost and operational implications of each of the three structural options should be evaluated.

The available options are as follows:*

1. Designate a private, non-profit corporation to administer the program including the guarantee function;

2. Assign responsibility for the program to an existing state agency, board, commission or public corporation; or

3. Assign responsibility for the program to a new state agency, board, commission or public corporation.

Not every state will have every option open to it because each state's situation is unique. For example, state constitutional provisions may prohibit direct state involvement and leave a private non-profit corporation as the only available option. However, states which have more than one option available should evaluate all such options, in terms of lender willingness to participate, agency accountability to the state, operating relationships with state government and costs.

---

* Under any one of these options, a comprehensive servicer may be selected.

C-2 The sources and types of state services available to state agencies (as well as related charges) should be identified and included within the scope of the study.

State services (e.g., data processing support) would most likely be available to all but the "pure" non-profit guarantee agency. The evaluation of the feasibility of a guarantee agency should include an understanding of what state services would be available, of what charges would be incurred and what lead times would be required to have such services in place.

States which elect to contract with a servicer need not gather as much information on this area since the servicer provides a total package which includes most of the kinds of processing support provided by the state to state agencies.

D. EVALUATION PHASE: Financial Projections

D-1 Multi-year financial projections should be performed.

Such projections can be used to test the financial impact of various policy options and to demonstrate the financial viability of a state guaranteed student loans program.

The period for the projections should be no less than ten years. The process of generating such projections requires that assumptions be defined with respect to loan volumes, default rates, loan lives, revenues and expenses.

D-2 A multi-year projection of staffing levels and staff skill requirements should be performed.

The workload in a guarantee agency increases as the cumulative volume of loans guaranteed increases and as the number, variety, and sophistication of services provided increases. Furthermore, as an agency's portfolio matures (i.e., loans enter repayment), defaults occur, claims are filed, and collections begin, all of which increase an agency's workload. This is a significant difference from grant programs in which the volume of work in any given year is largely independent of the volume of grants processed in previous years. Consequently, it would be deceptive to plan the staff requirements for only the implementation period and the first year or two of operations. A state which assumes the responsibility of a guarantor should understand the full scope of its commitment in terms of staff and staff compensation.

D-3 New agencies should plan to take advantage of economies of scale.

The most direct way in which a new agency could initially take advantage of economies of scale is to contract out services. Theoretically, a servicer which handles a volume larger than that generated by a single agency could provide services to the agency for less than it would cost the agency to perform equivalent services.

A series of multi-year cost comparisons would have to be performed. If such projections showed that a servicer would be cost-effective in the early years of program, the issue should still be addressed of whether it would be cost-effective to discontinue use of a servicer and begin to perform the activities in-house at some subsequent point in time.

The use of a servicer is not purely a cost question. There are other factors to consider, including the quality of service provided, the breadth of services available, and the extent of state control over a servicer-administered program.

E. IMPLEMENTATION PHASE: Initial Activities

E-1 Once a state authorizes a state guaranteed student loan program, the first task should be to select a policy body ("the Board") and hire/appoint a Director.

The Board should normally have some representation from the task force which recommended the creation of the guarantee agency. The Board should also include some representation of the various constituencies of a guarantee agency, definitely including key lenders and schools.

During implementation, the Board will be responsible for approving Board policies and the implementation budget.

The most important act of the Board will be to select a Director for the agency. Ideally, the person selected to be the Director should have prior management experience and/or prior experience in the banking/ lending community. Because the role of Director requires extensive contacts with an agency's constituents, the Director should have certain public relations skills. In order to maintain its flexibility to make changes, if required, the Board should seek exemption of the position from civil service status. The Board should also be prepared to compensate a Director on a competitive basis with the compensaton paid by other agecies of comparable size.

E-2 EDP systems development should be an integral part of the implementation of any agency.

A guarantee agency has a strong need for EDP system support because of the following factors:

- Paperwork volume;
- Repetitive processing tasks;
- Long term recordkeeping requirements;
- Summary statistical reports; and
- Record Access.

The EDP systems development effort should be initiated during the implementation phase and thoroughly tested before the first loan is guaranteed. Because of the lead time associated with an EDP system development, this issue should receive priority early in the implementation phase. Consideration should be given to purchasing an existing system. Data processing issues (and the availability of existing systems) should be discussed with other existing agencies. Comments of the larger lenders may also affect system design requirements.

F. IMPLEMENTATION PHASE: Program Development

F-1 Program planning should address all guarantee agency functions.

The following ten functions are performed or contracted out by guarantee agencies;*

1. Loan Approval;
2. Essential Loan Servicing;
3. Special Loan Servicing;
4. Preclaims Assistance;
5. Claims Processing;
6. Collections;
7. Lender Promotion;

---

* For additional detail on the activities which comprise these functions, see Appendix C to this volume.

8. School and Student Liaison;
9. Regulation and Compliance; and
10. Administration.

Each of these ten should be addressed as part of the planning process.

In order to have an effective agency, each of the functions, other than Special Loan Servicing (e.g., interest billing), must be performed at some level by the state, by a designated non-profit corporation, or by a servicer. The capability to do so should be in place at the time the guaranteed loan program becomes operational since each function contributes to the success of the program taken as a whole.

Certain functions (Preclaims Assistance, Claims Processing, and Collections) may be phased in over the initial years of the loan program's operating life. However, the performance of these functions must still be planned, and some level of basic staff time provided from the very beginning as part of a comprehensive default prevention effort.

F-2 New agencies should incorporate the "best practices" of existing agencies into their policies and procedures where applicable.

Although performing essentially the same general activities, the existing agencies have established a variety of approaches to accomplish approximately identical objectives. The experience of the existing agencies serve as a pool from which the staff of new agencies may draw. This approach should reduce the time and effort required for a new agency to become operational. It can also avoid a painful learning process which might adversely affect the early performance of a new agency.

Each new agency's requirements will differ. However, the management of existing agencies will be generally willing to offer advice on what practice may best meet the particular situation of a new agency. In addition, we have summarized the "best practices" which we encountered during our study* and are available to discuss their applicability to a new agency.

---

* See Chapter V of this volume.

F-3 New agency procedures should be documented.

It is important that internal procedures be assembled into an internal procedures manual which should be updated as required. This reduces the number of errors and can be useful for training new staff. Such a manual also establishes for management's use and knowledge the way things should be done and serves as a basis against which to measure what is being done on a periodic basis.

F-4 A financial accounting system must be developed before the agency begins guaranteeing loans.

The accounting system developed for a guarantee agency must meet a variety of requirements to include the controlling and reporting of the following:

- The periodic performance of the agency in terms of revenues earned and expenses incurred;
- The asset and liability structure of the agency;
- The funds available to meet potential defaults of student loans; and
- The status of Federal advance funds and the associated interest earnings.

In addition, the accounting system must provide for the identification of operating costs by certain agency functions. Under the provisions of the Education Amendments of 1976, the Administrative Cost Allowance and the 30% offset to the cost of collections are based in part on actual costs incurred for certain functions. The functions requiring specific cost allocation are Preclaims Assistance, Collections and Lender Promotion. In order to certify the level of costs incurred, new agencies must be prepared to collect costs by function on a routine basis and to document them.

Touche Ross & Co. as part of the technical assistance phase of this project, has prepared a prototype accounting system suitable for a typical state guarantee agency. However, in adapting this or any prototype system to a particular agency, it is necessary to review the specific control and reporting requirements of that agency.

F-5 A Management Information System should be developed during the implementation phase.

An integral part of the EDP systems development process will be the creation of a capability to produce a series of management reports. These will be of two types:

- Internal management reports which record operating activities (Loan Approvals, Preclaims Assistance, Claims Processing, and Collections); and
- External reports (designed primarily for the Office of Education).

Internal reports should show activities in a given period (e.g., the current month) and also show cumulative data for the current year and comparison against prior years and/or planned performance. External reports are submitted primarily to the Office of Education; the contents of these reports are specified by the Office of Education. External reports are the basis upon which an agency demonstrates its accountability to the Office of Education and to other external parties.

G. IMPLEMENTATION PHASE: External Relations

G-1 The Office of Education should be kept informed at each step in the process of creating a guarantee agency.

Throughout the development process, the management and staff of a new agency should be in contact with representatives of the Office of Education, especially with respect to interpretations of Federal law and regulations. The intent is to draw upon the experience and interpretations of the Office of Education to establish an effective rapport and limit delays in signing the required reinsurance agreement(s).

G-2 New agencies should assign the highest priority to the recruitment of lenders.

Lenders must agree to participate, sign the required agreements, and be oriented to the program prior to the first request for a loan guarantee being submitted to the agency.

Lender recruitment efforts should be directed towards high level lender management positions (e.g., the chairman, president or executive vice-president). At this level the guaranteed loan program appeals of public service, customer service and profit are probably best received.

Lender recruitment practices will vary according to the nature of the lender community in a given state (e.g., unit banking or statewide banking) and according to the standing of statewide lender associations (who may be approached to endorse the program to their memberships).

Active high volume lenders under the FISL program should be the first targets of the lender recruitment effort.

APPENDICES

Appendix A

DESCRIPTION OF TECHNICAL ASSISTANCE

Preface

The Office of Education has contracted with Touche Ross & Co. to offer technical assistance to guarantee agencies. The type of assistance will depend on whether the state is considering implementing an agency, has a new agency or has an existing agency. The following pages contain descriptions of the various categories of technical assistance and the respective projects which would be included in these categories.

SUMMARY DESCRIPTION

A. Category I: GUARANTEE AGENCY EVALUATION ASSISTANCE

There are several states that are not yet committed to establishment of a guarantee agency. The purpose of Guarantee Agency Evaluation Assistance is to provide support in these states to the state officials who are charged with studying the issues related to establishing an agency.

Guarantee Agency Evaluation Assistance may deal with a variety of topics ranging from the provision of basic background information to the conduct of detailed financial analyses of the options which face a state.

It is envisioned that Guarantee Agency Evaluation in a given state would include some or all of the types of discrete projects described below.

I.1 Analyze Guarantee Agency Options

The objective of this type of project would be to conduct a screening of the available options (including remaining under the Federal program) in order to identify those which would be sufficiently viable to allow further and more detailed study. Options to be considered would include organizational structures, levels of service, types of service, and sources of revenue. Impacts on lenders, schools, students and the state government would also be considered.

I.2 Develop Planning Assumptions

Given that a state wishes to seriously consider the creation of a guarantee agency, certain assumptions must be made. The objective of this type of project would be to develop the assumptions upon which detailed, multi-year operating and cost projections could be made for a given state.

Such assumptions would, at a minimum, include such variables as projected loan volume, growth of outstanding loans, default rates, reserve requirements, and loan demand. The development of these assumptions would involve interviews or meetings with representatives of lenders and of the financial aid community. Demographic factors which affect loan demand would also be considered.

I.3 Develop Cost and Revenue Estimates

For each viable option, given the planning assumptions, general multi-year estimates of operating, reserve and capital costs could be developed. These estimates would not be intended for determining the precise budget requirements, but would be suitable to provide another basis for evaluation of the options under consideration. In addition, revenue estimates for the same period could be prepared in order to determine the extent (if any) to which the guarantee agency would have to be subsidized from annual state appropriations or other sources.

I.4 Make Informational Presentations to State Officials

The basic purpose of this type of project would be to assist in the education of key legislative and executive staff members through the conduct of informational presentations to interested committees or other decision-making groups.

B. Category II: IMPLEMENTATION ASSISTANCE

After a State has decided to establish a guarantee agency, there are many detailed tasks that must be accomplished before the first loan can be guaranteed. This category of assistance is oriented to those states which have passed authorizing legislation (or have done whatever equivalent executive action is required) but have yet to guarantee their first loan.

The provision of technical assistance in the implementation area would aid new agencies to develop sound management practices. This is supportive of the Congressional intent that OE encourage the creation of new guarantee agencies.

For some states fiscal year 1979 is expected to be their first full year of operations. These new agencies should be considered as being in an operational shake-down period and are likely to require assistance even though they have begun to guarantee loans.

Listed below are some examples of the types of projects which would constitute implementation assistance. The list should not be considered complete since the needs of each state will be unique and may not be classifiable under the pre-defined projects listed below.

II.1 Develop an Implementation Plan

Some states have made the commitment to create a guarantee agency prior to developing a detailed implementation plan. Such a plan would be required in order to structure the implementation process. The purpose of this type of project would be to develop such a plan. The plan would include staff and budget requirements, as well as an estimate of the elasped time between legislative authorization and the initiation of operations.

II.2 Assist to Evaluate the Use of a Single Outside Servicer

Certain states will consider the use of a single outside servicer to provide a total processing and service package. Where this is considered a viable option, assistance would be available. Such assistance could include drafting specifications for inclusion in a Request for Proposal (RFP), as well as review and evaluation of contractor proposals.

II.3 Develop and Implement Accounting Systems and Other Financial Records Systems

The operations of a guarantee agency have several unique accounting and financial management aspects. In addition to the usual operations budget that a typical state agency might employ, a guarantee agency must provide for reserve fund accounting, identification of costs related to collections, and cost allocations for determining the Administrative Cost Allowance. These requirements are beyond the capabilities of most state government accounting systems and require special accounting procedures applicable to the guarantee agency. New agencies would be well advised to have such systems operational prior to processing loans and handling funds.

Because of Touche Ross & Co.'s knowledge of the requirements of the student loan program and experience in developing both manual and automated accounting systems, this is one area of technical assistance where the contractor can be of special assistance to new agencies. Touche Ross & Co. intends to work closely with the management in new agencies in order to determine the most suitable type and level of accounting support.

Two basic areas which require accounting support are:

- Reserve Fund Accounting - This involves the development of a recordkeeping system that will enable the agency to keep accurate records of revenue and expenditures for the loan guarantee reserve fund. Provisions would be made for recording Federal and state advances, state appropriations, earnings on investments, Federal reinsurance payments, collections and contributions or other revenue sources. Expense accounts would include: administration, claims payments, Federal reimbursement, and other substantial expenditures.

4

- Cost Accounting Systems - The Education Amendments of 1976 established an Administrative Cost Allowance payable to guarantee agencies for expenditures in conjunction with lender promotion, preclaims assistance, collections, and other administrative expenses. Some agencies have had difficulties in segregating expenses into functional areas even though there is a definite requirement for new agencies to establish an effective system to identify and collect costs by functional area. Such a system might consist of a chart of accounts and related subledgers to capture functional costs manually or, for a larger agency, the system might require an automated accounting system with its related cost codes and reports.

II.4 Develop and Implement Management Information Systems

Another requirement that a new agency must consider is that of management information needed to satisfy both internal and external reporting requirements.

- Internal Reporting Systems - A new agency must define the reports that will be used to satisfy internal management needs. These reports would provide current and historical data on volumes and on the important operational indicators of an agency. For example, a report might show the number of loan applications processed on a weekly basis with historical and seasonal trends indicated. A report such as this could be used to plan staffing levels, project forms inventory or define computer resource requirements. The important key in defining internal reports is a detailed understanding of an agency's operations.

- External Reporting Systems - Guarantee agencies are required to submit a series of external reports. As a result of the work performed by Touch Ross & Co. at established agencies, an understanding of external reporting requirements in the guaranteed student loan program was developed.

  Other external reporting requirements will also impact upon new agencies. These requirements will vary depending on the type of agency. For example, a nonprofit corporation will be required to submit forms to the Internal Revenue Service, Social Security Administration and various other Federal agencies. Guarantee agencies may also be required to submit reports to other State agencies. These reports all must be considered when planning an information system.

II.5 Develop Organizational and Staffing Plans

Many newly formed guarantee agencies may have difficulties in determining the appropriate organizational structure. From visits to existing State agencies, Touche Ross & Co. has gained an understanding of organizational and staffing patterns in guarantee agencies. After considering specific agency requirements, this knowledge would be the basis for assistance in formulating organizational and staffing plans.

II.6 Develop Design for Work Flow

New agencies will also need to consider how the basic loan guarantee functions will be performed. This will include such activities as loan application processing, loan servicing, and claims processing. The purpose of this type of project would be to develop a work flow design which would provide some operational approaches to processing the large volumes of paper which pass through an agency. The cost and other implications of using specialized external servicers would be considered within the scope of this type of project, as would the design of internal forms, the efficient layout of offices, and selection of specialized equipment (e.g., microfilm equipment).

II.7 Develop Written Procedures and Manuals

An important consideration in a new agency is the development of standard procedures for internal processes and instruction manuals for lenders and educational institutions. An item that has been mentioned by many agencies, schools and lenders is that they do not have current manuals that explain procedures and policies. It is recommended that new agencies generate such manuals during the implementation period. These manuals would assist the agency's staff to perform the basic processing activities as well as inform schools and lenders of program requirements.

Some of the written materials that must be developed include:

- State Guarantee Agency Loan Approval Procedures: describes how loan applications are processed, recorded and maintained.

- State Guarantee Agency Claims and Collection Procedures: describes how lender requests for assistance and claims are processed and how collection activities are conducted.

- State Guarantee Agency Lender Instruction Manual: includes legislative history, detailed instructions for forms completion, descriptions of "due diligence" requirements, and other information needed by the lender.

- State Guarantee Agency Educational Institution Manual: includes a description of the student loan program suitable for dissemination to students, detailed procedures for the financial aid office about student status verification and general information about lenders in the state.

C. Category III: OPERATING ASSISTANCE

In the course of visiting established agencies, Touche Ross & Co. observed several specific areas where improved management practices could be implemented. Various ways of improving operations were discussed with the established states during the visits. However, there remains a need for technical assistance to existing agencies.

Many of the technical assistance projects that will be performed in the category of operating assistance are similar to those described in the previous section on Implementation Assistance. The primary difference will be an emphasis on improvements and enhancements to existing processes rather than the development of new systems.

Operating assistance projects which have identifiable benefits for the non-agency states will be assigned a higher priority than projects which do not have any application to the non-agency states.

For some agencies it may not be possible to define a discrete technical assistance project as described below. Instead, it may be the opinion of agency management that its difficulties stem from problems not yet identified or not identified sufficiently to enable the agency to define a specific technical assistance project. To satisfy this need for problem definition, the scope of technical assistance will include a comprehensive review of work flow systems, management information systems, staffing utilization and internal controls in order to identify specific problem areas. The immediate product of this form of assistance will be a presentation to the agency management on problem areas and recommendations for corrective action. The recommendations would be incorporated into a management improvement plan prepared by the agency management with the assistance of the Touche Ross & Co. consultants. The management improvement plan would list the corrective activities to be undertaken and identify the responsible person and completion date for each activity. It is anticipated that the agency staff would be able to accomplish most of the activities without outside assistance. However, for certain activities, the agency may choose the alternative of requesting further technical assistance from OE.

Some examples of discrete projects are the following:

- Improve Management Accounting Systems

  Some states do not prepare periodic internal management reports based on accounting information. A project could be performed to define such reports and develop procedures for their preparation. The project might include additions to the chart of accounts so that specific expense data is segregated and assistance to agency accountants in revising their recordkeeping systems.

- Develop Cost Accounting Systems

  In many states, there are no cost accounting systems or procedures that can be routinely used to prepare accurate administrative cost allowance reimbursement requests. A project could be undertaken to develop cost accounting procedures for an agency to use in determining the costs of lender promotion, preclaims assistance, collections and other functions. This system could be either automated or manual depending on the specific requirements of the guarantee agency.

- Develop Improved Work Flow Design

  A project could be defined to review the flow of applications, claims and other agency forms for possible improvements. Each form would be followed as it is processed by various individuals in the agency so that bottlenecks or duplications of effort could be identified. Revised work flowcharts would be prepared to suggest improvements to the efficiency of processing.

These examples are only intended to demonstrate some of the possible projects that might be performed for existing guarantee agencies. Other projects such as procedure manuals, management information systems and staffing plans could also be accomplished under this category of technical assistance.

Appendix B

SUMMARY OF DATA COLLECTION GUIDE

SUMMARY OF THE DATA COLLECTION GUIDE

A. OBJECTIVES AND BACKGROUND

The Data Collection Guide used was a multi-purpose instrument which was designed for the collection and analysis of data related to existing Guaranteed Student Loan Program Agencies. The specific objectives of the Guide were as follows:

- To structure the collection process in order to allow the collection of the required data in the least time and with the least possible respondent burden;
- To organize the collected data in order to facilitate analysis on a consistent basis within and between states;
- To serve as a central, written record of collected data; and
- To facilitate the drafting of the interim and final reports by summarizing the state-by-state analysis.

B. GUIDE ORGANIZATION

The Data Collection Guide was organized into the following seven major sections:

- MANAGEMENT PERSPECTIVE;
- AGENCY BACKGROUND, LEGISLATIVE AUTHORITY, AND REGULATIONS;
- AGENCY ORGANIZATION;
- PROGRAM OPERATIONS;
- OUTSTANDINGS AND DEFAULT ANALYSIS;
- ACCOUNTING SYYSTEM AND FINANCIAL DATA; AND
- COST ANALYSIS

For each section a description of the objectives and a summary of the topics covered will be provided in this Appendix. For the Cost Analysis section a description of our methodology is included.

1. MANAGEMENT PERSPECTIVE

The objectives of this section were:

a. To collect qualitative information which can not be reduced to quantitative equivalents;

b. To provide an opportunity for agency management personnel to express their opinions in an open-ended interview structure; and

c. To capture the experience of the agency states for the benefit of the non-agency states who are considering creating guarantee agencies.

Summary of major topics covered were:

a. Demand for student loans and the factors which affected the level of participation by lenders and by students in the program;

b. Major recent and future changes planned in the organization and operations of the agency;

c. Adequacy of the agency's management information systems;

d. Impact of the 1976 Education Amendments on the operation of the guarantee program;

e. Recommendations for developing agencies; and

f. Impact (actual or theoretical) on the guarantee agency if the state were to act as a "lender of last report."

2. AGENCY BACKGROUND, LEGISLATIVE AUTHORITY, AND REGULATIONS

The objectives of this section were:

a. To understand the agency's background and legislative authority; and

b. To document the existing program regulations.

Summary of major topics covered were:

a. History of guarantee program including historical pattern of growth;

b. Description of other student financial assistance in the state;

c. Legislative authority; and

d. Regulations including lender, borrower and school eligibility requirements and loan maximums and minimums.

3. AGENCY ORGANIZATION

The objectives of this section were:

a. To document the size and structure of the Agency;

b. To understand the variety and scope of programs administered by the Agency; and

c. To understand the existing relationships with other State agencies.

Summary of major topics covered were:

a. Structure and programs administered by the Agency;

b. Policy making authority; and

c. Use of servicers.

4. PROGRAM OPERATIONS

The objectives of this section were:

a. To review processing functions for use in development of performance measures;

b. To identify management reporting proceduress; and

c. To document volume data on program operations.

Summary of major topics covered were:

a. Review of all functional activities:

   1) Loan Approval

   2) Essential Loan Servicing

   3) Special Loan Servicing

      a. Interest Billing

      b. Servicing Lender Held Loans

      c. Positive Student Status Verification

   4) Preclaims Assistance

   5) Claims Processing

   6) Collections

   7) Lender Promotion

   8) Regulation and Compliance

   9) School and Student Liaison

b. For each function performed the procedures, regulations affecting the function, historical patterns, policy issues, and internal and external reports generated were covered.

5. OUTSTANDINGS AND DEFAULT ANALYSIS

The objectives of this section were:

a. To identify agency practices for maintaining outstandings data; and

b. To determine outstandings data for use in trend analysis.

Summary of major topics covered were:

a. Definition and sources of data items for the Form 1130 and the Quarterly Claims and Collections Report;

b. Default rate; and

c. Loan Write-off Policy.

6. ACCOUNTING SYSTEM AND FINANCIAL DATA

The objectives of this section are:

a. To understand the budgetary process, the accounting system and the reports available from that accounting system;

b. To document the Agency's FY77 income and expenses;

c. To allocate the time of agency personnel to a specific set of agency functions; and

d. To determine the type and amount of costs incurred by the Agency in the conduct of specific guarantee program functions.

Summary of major topics covered were:

a. Background including description of fiscal year, audit process, and method of accounting system;

b. Capital expenditures;

c. Support services provided by the state;

d. Program income;

e. Program expenses including labor and other operating costs;

f. Reserve account;

g. Financial impact of Education Amendments.

7. COST ANALYSIS

The objectives of this section were:

a. To allocate identified program costs by specific program functions; and

b. To utilize the cost allocation methodology in order to have consistent and meaningful cost data.

Methodology of the Cost Analysis:

a. Allocation of direct labor costs (including fringe benefits)

Direct labor costs were allocated on the percentage of time spent by employees in the guarantee program and by each function. Interviews were conducted with supervisors and/or individual employees to obtain this information. The actual FY77 payroll including fringe benefits per employee was obtained and allocated based on the percentage of time devoted to each function.

b. Allocation of Operating Costs

Services were sometimes provided by the state. Unless the chargeback seemed significantly at variance with the experience of other agencies, the chargeback by the state became the operating cost for purposes of the analysis. When no chargeback was made by the state, a cost was imputed based on our experience in other states.

All operating costs used in the allocations were for FY77 and were reconcilable to the Agency's FY77 financial statements.

During our analysis, the following cost categories were used:

1. Occupancy and Utilities;
2. Data Processing;
3. Professional and Servicer Services;
4. Furniture and Fixtures;
5. Office Supplies;
6. Forms;
7. Postage;
8. Telephone;
9. Miscellaneous Expenses.

Individual vendor receipts were reviewed in each category. When a receipt could be clearly identified, (e.g., a printing order for loan applications), it would be allocated to the appropriate function. If costs could not be allocated to a specific function, the costs would be allocated based on the percentage of Full Time Equivalent staff (FTE's) devoted to each function.

1. Occupancy and Utilities: Those costs were allocated based on the floorspace allocation. For example, the cost of the Director's space would be allocated based on his time devoted to the various functions.

2. Data Processing: This category included the cost of renting any data processing equipment. The allocation was based on the machine utilization/transaction volume.

3. Professional Services and Servicer Charges: This allocation was based on contracts and billings. For example, the cost of collection agencies would be assigned to the cost of Collections.

4. Furniture and Fixtures: If the costs were significant, instead of expensing the item, a depreciation schedule would be established, and the depreciation expense would be included in the allocation.

5. Office Supplies: This allocation was based on the percentage of FTE's devoted to each function.

6. Forms: Bills were analyzed, and when one could clearly label a bill to a specific function the cost would be allocated to that function. The remaining costs would be allocated based on the percentage of FTE's devoted to each function.

7. Postage: Those postage costs for Loan Approval, Essential Loan Servicing, Positive Student Status Verification, Preclaims, Claims, and Collections which could be identified would be allocated to those specific functions. The remaining costs were allocated based on the percentage of FTE's devoted to each function.

8. Telephone: The long distance portion of the bill was generally incurred for Preclaims, Claims, Collections and Administrative functions. A methodology for allocation of the long distance bill would be established based on the agencies' practices. The remaining charges, usually local charges, were allocated based on FTE's devoted to each function.

9. Miscellaneous Expenses: If they could be assigned to a specific function then they would be. Normally, the percentage of FTE's devoted to each function would be the basis for allocation.

10. Imputed Costs: If the state provides the agency with one or more services for which there was no reasonable charge-back and the charge would be material (for purposes of this analysis, material meant equal to or greater than 3% of total operation costs), then an imputed cost was developed. For example, in one state, the state did not charge the guarantee agency the cost of fringe benefits. In that case an imputed charge was developed. The calculation of imputed costs in general was based upon reasonable charges levied upon other agencies by their respective states or commerical vendors, adjusted for the particular situation of the agency.

11. Overhead Costs: In multiprogram agencies often there were agency overhead costs which had to be allocated to the guarantee program. Overhead represented the costs associated with the functions of top management of a multiprogram agency. These costs included labor costs and operating costs. Direct operating costs which were associated with programs other than student loans were backed out. The overhead costs were then allocated to the guarantee program based on the distribution between student loan FTE and the total FTE of the multiprogram agency less overhead FTE. Overhead costs were not allocated by function, but were assigned to the function of Administration.

Appendix C

GUARANTEE AGENCY FUNCTIONS

Appendix C

GUARANTEE AGENCY FUNCTIONS

GUARANTEE AGENCY FUNCTIONS AND COMPONENT ACTIVITIES

1. LOAN APPROVAL PROCESSING
    a. Receiving of applications for purpose of insurance determination;
    b. Reviewing the applications;
    c. Making insurance determinations;
    d. Informing lenders of decisions;
    e. Payment of lender fees (if any);
    f. Recording the decisions;
    g. Processing student fee payments; and
    h. Establishing records of loans guaranteed.
2. ESSENTIAL LOAN SERVICING
    a. Maintaining records of loans guaranteed;
    b. Contacting students and/or lenders at graduation;
    c. Distributing student status verification mailers - direct return to lenders;
    d. Reconciling agency loan records with lender loan records; and
    e. Generating management reports on the status of the portfolio.

3.A. SPECIAL LOAN SERVICING - Interest Billing System

- a. Auditing lenders' portfolios for inclusion in the interest billing system;
- b. Maintaining billing systems and loan records;
- c. Preparing the U.S. Office of Education invoice;
- d. Receiving funds and disbursing said funds to lenders; and
- e. Preparing lender reports on portfolio balances.

3.B. SPECIAL LOAN SERVICING - Servicing Lender Held Loans

- a. Auditing lenders' portfolios for inclusion in the servicing system;
- b. Maintaining servicing systems and loan records;
- c. Undertaking student billing for unsubsidized interest;
- d. Providing billing and payment processing service for loans in payout; and
- e. Providing reports on portfolio status to lenders.

3.C. SPECIAL LOAN SERVICING - Positive Student Status Verification

- a. Distributing student status verification mailers - direct return to agency;
- b. Tracing borrowers whose addresses have changed; and
- c. Notifying lenders of the student status of borrowers.

4. PRE-CLAIMS ASSISTANCE

- a. Processing lender requests for assistance;
- b. Attempting to contact borrowers, references, and cosigners as part of pre-claims assistance; and
- c. Reporting to lenders on the progress of pre-claims assistance.

5. CLAIMS PROCESSING

- a. Receipt of claims;
- b. Review of claims;
- c. Making determinations on claims;
- d. Informing claimants of decisions;
- e. Authorizing and disbursing claims payments;
- f. Preparing claims for Federal reimbursement of paid lender claims;

g. Forwarding and status monitoring of Federal reinsurance claims; and

h. Receiving and recording Federal funds paid in response to filed claims.

6. COLLECTION

a. Attempting to locate and contact borrowers after notes have been purchased;

b. Receiving, recording and depositing funds received;

c. Undertaking legal actions against borrowers;

d. Referring cases to, monitoring, and paying a commercial collection firm;

e. Establishing and servicing repurchase agreements with lenders for loans in which repayment is resumed; and

f. Reporting collections and making proportionate reimbursement to the U.S. Office of Education.

7. REGULATION AND COMPLIANCE

a. Generating and promulgating regulations;

b. Developing materials to communicate regulations to lenders and educational institutions;

c. Performing compliance activities (e.g., unannounced visits to review files) to insure that lenders are adhering to regulations; and

d. Undertaking to limit, suspend or terminate institutions which have failed to abide by the regulations of the program.

8. LENDER PROMOTION

a. Presenting speeches before general and special audiences of lender representatives;

b. Undertaking direct contacts with lenders for the purpose of stimulating participation in the program;

c. Holding lender workshops; and

d. Designing and administering participation incentives (e.g., loan origination fees).

9. SCHOOL AND STUDENT LIAISON

a. Presenting speeches before student financial aid organizations and before student bodies;

b. Visiting high schools and institutions of higher learning for the purpose of promoting the program;

c. Development and publication of brochures specifically for distribution to, and use by, educational institutions; and

d. Generating loan reports by school for the purpose of promoting the program.

10. ADMINISTRATION

Administration for the guarantee program includes program management activities which cannot be easily classifiable with the functions described above. Examples of activities which would be included within Administration include the following:

a. Agency overhead in multiprogram agencies;

b. Performing liaison activities with representatives of other States and of the Federal Government;

c. Preparing and submitting monthly and quarterly reports;

d. Drafting and presenting the annual budget to the legislature;

e. Formulating and implementing personnel policies for the Agency;

f. Negotiating supply and other contracts with outside contractors;

g. Investing reserve funds; and

h. Providing accounting support.

Appendix D

GUARANTEE AGENCY STATUS
BY STATE

NON-AGENCY STATES*
(as of May 31, 1979)

1. Alabama
2. Arizona
3. Colorado
4. Hawaii
5. Mississippi
6. Missouri
7. Montana
8. Nebraska
9. North Dakota
10. Pacific Islands
11. Puerto Rico
12. Texas
13. Washington
14. West Virginia
15. Wyoming

---

* Significant actions toward the formation of a guaranteed agency are in process in many of these states.

D-2

NEW AGENCY STATES*
(as of May 31, 1979)

1. California
2. Florida
3. Idaho
4. Indiana
5. Iowa
6. Kansas
7. Kentucky
8. Minnesota
9. New Mexico
10. South Carolina
11. South Dakota
12. Utah
13. Virgin Islands

---

* Established subsequent to the passage of the Education Amendments of 1976. All of these states have signed the required reinsurance agreements with the Office of Education.

D-3

ESTABLISHED AGENCY STATES*

1. Alaska
2. Arkansas
3. Connecticut
4. Delaware
5. District of Columbia
6. Georgia
7. Illinois
8. Louisiana
9. Maine
10. Maryland
11. Massachusetts
12. Michigan
13. Nevada
14. New Hampshire
15. New Jersey
16. New York
17. North Carolina
18. Ohio
19. Oklahoma
20. Oregon
21. Pennsylvania
22. Rhode Island
23. Tennessee
24. Vermont
25. Virginia
26. Wisconsin

---

* Established prior to the passage of the Education Amendments of 1976.

Appendix E

DIRECT LOAN PROGRAMS

A. INTRODUCTION AND BACKGROUND

Direct loan programs have been established by many states to supplement the loans provided by commercial lenders so that sufficient loan capital is available to satisfy the demand for loans in the state. In some states, students are not able to secure student loans from commercial lenders because of restrictions imposed by the lenders. For example, the following restrictions are imposed by some commercial lenders:

- Loans are not made to first-year students;
- Loan amounts are not approved for more than $1,000; or
- Loans are only available to established customers of the lending institution.

States have recognized a need to make loans available to students who cannot get loans from commercial lenders but who are otherwise eligible. These loans are made from a direct state loan program managed by a state agency or a non-profit corporation. The stated purposes of the direct loan program differ from state to state but generally fall into three categories:

1. Lender of Last Resort

   These direct loan programs are for students who have been denied loans by the commercial lending community. In most states, a student can also be denied a loan by the direct loan program if certain criteria (e.g., a residency requirement) are not met.

2. Health Care Profession Loan

   These direct loan programs are for students studying in specific health care fields. These loans usually are made in amounts greater than those available from commercial lenders under the Guaranteed Student Loan Program.*

3. Primary State Lender

   These programs have been developed to be the only source of student loans within a state. The state banking community sometimes funds these programs by purchasing revenue bonds.

---

* The need for this type of direct loan program will decrease because of the new Federal Health Education Assistance Loan (HEAL) Program.

Since direct loan programs are usually operated under the authority of the state legislature, most programs have some restrictions as to loan availability. These restrictions vary but residency is always required. Some states restrict loans by type of school, require satisfactory academic performance or full-time status. In two states, a portion of the loan amount is forgiven if the student completes a degree in a specific field of study or works full-time in the state for a certain period of time.

During our visits to the state guarantee agencies, we collected data on several direct loan programs. Exhibit E-1, DIRECT LOAN PROGRAM CHARACTERISTICS, summarizes the operating characteristics of these programs.

B. DIRECT LOAN PROGRAM ORGANIZATIONAL RELATIONSHIPS

1. Federal Government

Direct loan programs are recognized as eligible lenders under Federal regulations and many make loans that qualify for interest subsidies and special allowances from the U.S. Office of Education. Loans made by direct lenders may be insured directly by the Federal government through the FISL program or insured by a state guarantee agency and then reinsured by the Federal government.

2. State Guarantee Agency

Since direct loan programs are subject to the regulations and rules of the state guarantee agency in the states where they exist, direct loan programs must function as administratively separate organizations. We have seen three approaches taken:

a. State Agency

A separate organizational entity with its own management and staff is established to administer the direct loan program. This ensures that the loan program operates independently of the guarantee agency.

b. Non-profit Corporation

In some other states, a non-profit corporation has been established to administer the direct loan program. This arrangement is required in those states that have constitutional prohibitions against the state's involvement with direct lending.

Exhibit E-1
Page 1 of 1

Direct Loan Program Characteristics

State A/	Year Began Operations	FY77 Volume (million)	FY77 Loans as Percentage of All GSLP Loans	Approximate FTE Staff	Source of Loan Funds
1. Alaska	1971	$ 3.9	B/	16	State Appropriations
2. Georgia	1965	2.2	12%	4	State Appropriations
3. Kansas	1977	10.7 3/	56%	6	Revenue Bonds
4. Michigan	1976	12.9	28%	8	Revenue Bonds
5. Minnesota	1973	26.0	61%	18	Revenue Bonds
6. New Jersey	1977	D/	N/A	3	Excess Reserve Funds
7. North Carolina	1972	5.5	100%	32	Revenue Bonds
8. South Carolina	1974	2.8	100%	9	Revenue Bonds
9. Wisconsin	1933	13.1	27%	19	Revenue Bonds

A/ In addition to these states where we collected detailed information, the following states operate or are planning direct loan programs: Arkansas, Florida, Kentucky, Mississippi, New Mexico, Oklahoma, Tennesee, Texas, and Virginia.

B/ Alaskan direct loans are not federally reinsured.

C/ Eleven months only.

D/ Program not established for a full year but $920,000 had been loaned through February, 1978.

c. Guarantor Administered

In a very small number of states, the direct loan program is administered by the guarantee agency. This organizational arrangement is complicated to administer and raises questions with respect to adequate separation between the lending function and the guarantee function.

Another facet of the relationship between guarantor and direct lender is the sliding scale for Federal reinsurance. A high volume of defaults in the direct loan program may affect the ability of the guarantee agency to continue to qualify for 100% reinsurance from the Office of Education.

3. Education Institutions

Schools usually play an important role in the direct lending program. Formal agreements with the schools give the Financial Aid Officers (FAO's) the responsibility to act as loan officers for direct loans. Often an FAO must counsel students about their loan responsibilities and make a determination of the proper loan amount for the individual. As a result, the financial aid office becomes the local agent for the direct lender.

4. Commercial Lender

Commercial lenders are usually affiliated with the direct lender in one of two ways:

a. Borrower Referral

Many direct loan programs require the student to attempt to secure a loan from the commercial lending community prior to making a direct loan. This may involve commercial lenders signing a loan denial form or simply referring the student to the direct loan program.

b. Direct Loan Program Funding

In some states the direct loan program is funded by the commercial lending community. This is accomplished through a revenue bond issue that is purchased by the state commercial lenders.

5. Student Loan Marketing Association (Sallie Mae)

Some state direct loan programs have established formal agreements with Sallie Mae to ensure that their loan funds will have liquidity. Sallie Mae is paid a fee to guarantee that the eligible notes in the direct loan portfolio will be eligible for purchase by Sallie Mae.

C. DIRECT LOAN PROGRAM OPERATIONS

1. Operations

A direct lender must perform the same functions as any commercial lender. These functions include:

a. Application Processing and Fee Collection;

b. Loan Disbursement;

c. Loan Servicing Prior to Repayment;

d. Conversion to Repayment;

e. Loan Servicing During Repayment;

f. Paid-in-full Processing;

g. Delinquent Loan Processing; and

h. Claims Processing.

In addition to these operational functions, the direct lender must perform several administrative functions including: Accounting, Interest Billing to the Office of Education and General Program Administration.

2. Sources of Funds

Direct loan programs require both loan capital and operating funds. The sources of these funds differ from state to state but generally can be categorized as follows:

a. State Appropriations

In those states that have the direct loan program administered by a state agency, operating funds are often appropriated.

b. Revenue Bonds

Many states have authorized the direct loan program to issue revenue bonds. These bonds are not usually general obligations of the state.

c. Federal Payments

Direct loan programs are eligible for Federal interest subsidy and special allowance payments on the loans in the portfolio. These Federal payments are usually sufficient to pay any interest due on outstanding revenue bonds as well as possible operating funds for program administration.

d. Loan Repayments

As borrowers enter repayment, payments of interest and principal begin to replenish the loan fund. These payments are used to pay the principal due on revenue bonds.

e. Interest on Investments

Interest earned on capital not yet used for loans can be a source of operating funds for the direct loan program.

f. Other

In some states loan funds are made available from pooled assets of commercial lenders or by means of a low interest loan from a group of commercial lenders. Other agencies may also borrow funds at a reduced rate from the state.

D. IMPACT ON COMMERCIAL LENDERS

1. Lender Comments

During our data collection visits, we interviewed a small number of lenders concerning the effect that a state direct loan program would have on commercial lender participation. The responses are summarized below.

Lender Comments

●	Lenders in support of direct loans:	8
●	Lenders opposed to direct loans:	17
●	Lenders with no opinion:	11
	Total lenders interviewed	36

a. Supportive Comments

Three reasons were most often stated in support of direct loans:

- Direct loans better serve the student's financial needs and can reach a broader market;
- Direct loans allow commercial lenders to reduce their participation; and
- Students need a lender of last resort.

b. Comments in Opposition

Eleven of the lenders opposed to direct loans stated that the direct loans would decrease participation by commercial lenders. Other comments included:

- Direct loans will result in higher default rates;
- State agencies are not qualified lenders;
- Direct loans are a waste of taxpayer money; and
- Direct loan programs are not a proper function of government.

2. Actual Experience

One argument made against direct loan programs is that such programs drive out commercial lenders rather than supplement private sector lending. Because large direct loan programs funded by revenue bonds are relatively new programs, information on the impact of direct lending on commercial lending is scarce.

For Wisconsin and Michigan we were able to collect actual data about direct loan program volumes and commercial lender volumes for a period of years. This information is shown on Exhibit E-2, COMPARISON OF COMMERCIAL AND DIRECT LENDING VOLUMES. As shown in that Exhibit, commercial loan volumes increased even though direct loan programs were in operation. The data for Wisconsin shows that commercial lender participation as a percentage of total loans actually increased in recent years.

E. SECONDARY MARKETS

State secondary market programs have been implemented or planned in order to assure liquidity for commercial lenders in five states. Connecticut and North Dakota have established secondary market programs which have been operational for several years. Utah and Kentucky are in the process of implementing secondary market programs funded with revenue bonds. Illinois has developed a secondary market for delinquent loans using funds raised through revenue bonds.

1. Connecticut

The Connecticut Student Loan Secondary Market Loan Purchase Program (Susie Mae) was established in 1972 and is operated by the State Treasurer using funds from Connecticut's Short-Term Investment Fund.

Purchased loans are serviced by the lenders or their appointed servicers, and a fee is paid by Susie Mae for these services. To date only loans in interim status have been purchased. As of October 1, 1977 Susie Mae had purchased approximately $40 million in student loans.

2. North Dakota

The Bank of North Dakota (which is owned by the state and operates as a state agency) serves as a state secondary market. The objective is to provide liquidity to small commercial lenders which might otherwise be reluctant to continue in the program. As of December 31, 1977, the bank had purchased approximately 1,800 loans ($2.2 million).

3. Kentucky

The Kentucky Higher Education Student Loan Corporation (KHESLC) was established in 1978 by the Kentucky legislature to raise funds, purchase loans and service loans. Revenue bonds were issued to provide funds for loan purchases in the following priority order:

Exhibit E-2
Page 1 of 1

Comparison Of Commercial And Direct Lending Volumes
(millions)

	MICHIGAN A/			WISCONSIN B/		
YEAR	Commercial Lenders	Direct Lender	Total	Commercial Lenders	Direct Lender	Total
FY78	$32.4 (69%)	$14.7 (31%)	$47.1 (100%)	$40.3 (79%)	$10.6 (21%)	$50.9 (100%)
FY77	31.3 (92%)	2.8 (8%)	34.1 (100%)	24.7 (66%)	12.5 (34%)	37.2 (100%)
FY76	23.8 (100%)	-	23.8 (100%)	19.0 (57%)	14.4 (43%)	33.4 (100%)
FY75	21.9 (100%)	-	21.9 (100%)	17.6 (60%)	11.6 (40%)	29.2 (100%)
FY74	17.3 (100%)	-	17.3 (100%)	14.8 (64%)	8.3 (36%)	23.1 (100%)

A/ The Michigan Direct Loan Program began making loans on January 1, 1977. The state acts as a lender of second resort only. Funding for the program is provided by state revenue bonds.

B/ The Wisconsin Direct Loan Program began operating in 1933. In FY77, it began acting as a lender of second resort. The program is now funded by state revenue bonds.

a. The state direct loan program FISL portfolio;

b. FISL loans to students for academic year 1978-79 along with previous FISL loans to the same student;

c. Loans guaranteed by the new state guarantee agency for students who previously had FISL loans;

d. Existing private lender FISL portfolios that have not yet entered repayment; and

e. Existing FISL portfolios in repayment.

4. Utah

A new state guarantee agency has recently been created in Utah. In order to reduce the impact on commercial lenders of maintaining student loan portfolios which include both state and federally guaranteed loans, a secondary market operation has been authorized. Revenue bonds have been issued to raise funds which will be used to buy FISL loans from Utah's commercial lenders.

5. Illinois

The Illinois Designated Account Purchase Program (IDAPP) purchases delinquent loans from commercial lenders who meet certain requirements. The purpose of the program is to reduce the default rate on these loans by using a more aggressive default prevention effort. The lenders experience lower costs because problem loans are sold to an agency of the state rather than being worked by the lenders.